



Centre for Tax Policy and Administration

Consumption Tax Guidance Series: Paper No 3

Electronic Commerce: Verification of Customer Status and Jurisdiction

VERIFICATION OF CUSTOMER STATUS AND JURISDICTION

Caveat

Consumption Tax Guidance is a means of developing greater awareness of both policy and administrative issues. On policy issues the Guidance contains recommendations to member governments that are aimed at removing conflicts, distortions and disincentives to international trade. The section on administrative issues has been developed as a result of sharing experiences between member countries. The OECD's Committee on Fiscal Affairs has approved the contents and countries are encouraged to apply the guidance wherever possible. Nothing contained herein binds member countries, although where there is clear consensus amongst the member countries, administrations should consider the guidance in the light of their existing taxation systems and their legislative approaches.

VERIFICATION OF CUSTOMER STATUS AND JURISDICTION

1. A key principle of the Ottawa Taxation Framework Conditions is that the rules for the consumption taxation of cross border electronic commerce should result in taxation in the jurisdiction where consumption takes place.
2. The Guidelines on the Definition of the Place of Consumption for the Consumption Taxation of Cross Border Services and Intangible Property in the Context of E-Commerce provide that the place of consumption, and therefore the place of taxation, for cross border supplies of services and intangible property that are capable of delivery from a remote location, should be the jurisdiction:
 - i. In which the recipient has located its business presence for business-to-business transactions¹ (B2B); and
 - ii. In which the recipient has his or her usual place of residence for business-to-consumer transactions (B2C).
3. The recommended collection mechanism for B2B transactions, where the supplying business is not registered and is not required to be registered for consumption tax in the country of the recipient business, is the reverse charge (or self-assessment) mechanism. This means that a supplier would not be required to charge and collect consumption tax on supplies it made to businesses outside its jurisdiction. For B2C transactions the reverse charge/self assessment mechanism was not considered appropriate and in the interim it is acknowledged that where countries consider it necessary, a registration system is currently the only practical means to ensure the collection of tax on B2C transactions. Such a system would require the vendor to collect tax on cross border transactions.
4. The ascertainment of a customer's status (business or private) and jurisdiction is central to the vendor making the right tax decision. The right tax decision depends on whether the customer is established in the same taxing jurisdiction or abroad and whether that customer is a business or a private customer.
5. This guidance paper provides practical guidance on mechanisms that may be used to establish the status (business or private) and jurisdiction of the customer in the context of electronic commerce.

Context

6. The guidance proposed in this paper represents the minimum requirements primarily applicable to low value transactions where the vendor does not have an established relationship with the customer. It does not apply to high value B2B transactions where the vendor and the customer have an established relationship. In these cases the supplier is normally aware of the customer's status and jurisdiction and no additional verification process of the customer's declaration should be necessary. Ultimately the administrative guidance established will need to reflect the realities of the law and practice within a particular jurisdiction.

¹ In certain circumstances, countries may use a different criterion to determine the actual place of consumption where the application of the main criterion would lead to a distortion of competition or avoidance of tax. For further information see CTG 003 Commentary on Place of Consumption for ^{Business-to-Business Supplies (Business Presence)}

7. The mechanisms highlighted in this guidance should be considered as a basis for governments to provide clear, realistic and consistent guidance for business on the nature and type of verification that is required to determine the status and jurisdiction of a customer with the expectation that they would follow such guidance in good faith. Revenue authorities should consider the nature, type, scale and quantum of revenue applicable to each transaction when developing guidance, to ensure that the administrative response is weighed against the costs of compliance for business and the revenue at risk.

8. The guidance is designed to be used in cases where taxpayers are attempting to comply with their legal obligations. Nothing in the guidance is designed to limit a country's response to deliberate fraud or evasion.

Conclusion

As the ascertainment of a customer's status (business or private) and jurisdiction is central to the vendor making the right tax decision, revenue authorities should provide guidance to business on the nature and type of verification that is required to determine the status and jurisdiction of a customer. In developing this guidance revenue authorities should consider the nature, type, scale and quantum of revenue applicable to each transaction, to ensure that the administrative response is weighed against the costs of compliance for business and the revenue at risk.

Establishing and verifying the status and jurisdiction of a business customer

9. For low value transactions, where the vendor does not have an established relationship with the customer, the customer's declaration is an essential part of the tax decision process. However, because the reverse charge/self assessment tax collection mechanism² allows business customers to receive the services without being charged tax by the vendor, private customers may have a financial incentive to declare that they are businesses. As a result, customer declarations, when used as the only means of determining the tax jurisdiction, would not be fully reliable.

10. Therefore, in addition to the customer declaration, consideration has been given to three possible methods of verifying the customer declaration

- A. Verification of registration numbers
- B. Other indicia
- C. Digital certificates

A) *Verification of registration numbers*³

Online Verification

11. Today, at least in some jurisdictions, verifying the status of the customer is a relevant consideration for a vendor in making a taxing decision. For example, within the European Union (EU) the status of the

² The reverse charge/self assessment tax collection mechanism is the recommended approach for the collection of tax on B2B supplies.

³ It should be borne in mind that not all jurisdictions use VAT registration numbers and what follows in this section is, therefore, applicable only to those transactions to countries utilising registration numbers.

customer in cross border transactions is a significant factor. Supplies to taxable persons who are registered for VAT purposes are subject to a reverse charge/self assessment mechanism, whereas supplies to persons who are not registered for VAT purposes are taxed according to the particular rules that apply to that transaction.

12. In those jurisdictions where the VAT registration status of the customer is significant there appear to be mechanisms to support the decision making process of the vendor. In the case of the EU, the VAT Information Exchange System (VIES) fulfils this role by an online verification system. Other jurisdictions may have similar systems whereby it is possible to check the VAT registration number for validity, albeit not in an automated fashion or in real time.

13. At present, in intra-EU supplies, the customer, if VAT registered, will supply their VAT number to the vendor during the transaction. The customer is making a self-declaration about their status. Where it becomes necessary for the vendor to check the VAT number provided, they can do this by reference to the VIES. The VAT number supplied by the customer can also be used to compare business name and address information contained on the VIES database with name and address information provided by the customer to the vendor.⁴

14. For such an approach to have global application, jurisdictions outside the EU would also need to have a VAT/GST registration database, which is not always the case. Further, the relevant parts of the VAT registration databases of all jurisdictions would need to be publicly available, at least to the extent required to verify individual numbers. This would allow a vendor from any jurisdiction to validate the VAT registration status of a customer from any jurisdiction.

15. As online customers may expect everything to be approved at the time of the transaction, if the VIES or a comparable system is going to be a mandatory part of any transaction there will be very compelling arguments to make online registration data available in a format or interface that allows automated integration with vendors' systems.

16. Because this online method of determining the status of the customer will not always be available a validity computation on declared registration numbers could be used as an alternative.

Computation System

17. This alternative method for online verification of registration numbers would be a validity computation on declared registration numbers, which would only yield a certain answer if the numbers were genuine. This may be an extension of the check digit technique, which is already used for some registration number systems. The diversity of registration numbers, some of which may include alphabetical characters and not all of which will be in the roman character set, means that this process may be quite complex and would

⁴ The information may be provided during the transaction or it may be provided as part of some earlier customer registration process and stored in the customer database of the vendor. The vendor may obtain immediate confirmation of the VAT numbers validity of their trading partners through the VIES web site (accessible by the general public via the Internet) (<http://europa.eu.int/vies>). Nevertheless, traders, making an enquiry as to whether a specific VAT number is correctly associated with a specified trader name and/or address, should go through their national Central Liaison Office which will give one of the following replies: Yes, valid VAT number / No, invalid VAT number / Yes, the VAT number is associated with a given name/address /No, the VAT number is not associated with a given name/address (N.B. For security and data protection reasons, the national administrations will not supply the name and address in relation to a valid number).

therefore not be a short-term solution. In addition, this system may not take into account possible changes in a taxpayer's situation, for example when a taxpayer ceases to be registered in a jurisdiction. The requirement for frequent changes in VAT/registration numbers should also be avoided if this approach is to have merit. Any computation system will need to guard against reverse engineering.

18. Finally, whatever the registration number verification used (online or computation) some private customers may use existing genuine VAT numbers belonging to others to obtain tax-free supplies. Thus, other mechanisms such as indicia and digital certificates should be considered to verify customer's declarations about their status.

B) Indicia

Payment System Data

19. A possible method of verifying the status of a customer could be via the payment mechanism. For example, if the customer paid by credit card would it be possible to use card information to determine the status of the customer?

20. Based on the available evidence, it is unlikely that credit card information would in the short term be of assistance in determining the status of a customer. Only minimal information about cardholders is passed to vendors (for privacy protection) and the status of the cardholder is not computable from the card number in the current credit card system.

21. It should be noted that there are commercial reasons to reduce credit card fraud by improving the ability to identify authorised users of the credit card payment facilities. In time these developments may assist in the improved identification of the jurisdiction of a customer.

22. Payment mechanisms such as bank transfer (more used for large-scale transactions than credit cards) and payment arrangements in the contracts may be used as complementary verification methods.

Nature of the supply

23. The nature of the supply may provide an indication of the customer's status. For example, supplies of digitised music or films, with no entitlement to the embedded intellectual property rights, might be indicative that the customer was not VAT registered. Even if the customer is VAT registered it is likely that the supply would be for personal use and not a business input. Using this same indicative approach, business accounting software is much more likely to be a B2B rather than a B2C sale.

24. Even if the nature of the supply can offer reasonable presumptions there are limitations to this method of verifying the status of the customer. For example, it could be difficult to distinguish between anti-virus software sold to a private customer and the same software sold to a small business for business purposes.

C) Digital Certificates

25. The use of digital certificates may help determine the tax status of a customer. Some jurisdictions have issued digital certificates for business-to-government (B2G) transactions and some companies are issuing digital certificates to their customers. Tax authorities should normally be able to recognize the authenticity of digital certificates where they are interoperable (such as being based on the x.509 standard) and are issued in a high integrity manner.

26. The integrity of such certificates includes consideration about who issued the certificate, how the information contained on the certificate was validated and whether there is scope to include particular information about VAT registration status and jurisdiction. If these matters could be addressed this approach offers the best possibilities, because it could be conducted in real-time and with greater reliability than other methods.

Mismatch of customer self declaration with other indicia

27. In cases where the customer’s self declaration is not in agreement with other indicia used to verify the declaration, revenue authorities should consider providing additional domestic guidance as to how to tax these transactions. Where the vendor cannot regard the customer as a business customer, because, for example, the customer cannot provide a valid VAT number or digital certificate, this might lead to the presumption that it is a private customer and VAT should be charged accordingly.

Conclusions

For low-value transactions, where a vendor and customer do not have an established trading relationship, some of the criteria above may be used to verify the declaration of the customer.

The jurisdiction of the business customer should be ascertained in the same way, and at the same time as its status. For example, online verification of the VAT number may allow verification of the jurisdiction of the customer (in or outside the jurisdiction of the vendor) and their VAT registration status at the same moment, where the VAT registration number contains a country code, or some similar device.

Revenue authorities should consider providing additional domestic guidance as to how to tax a transaction, where the self-declaration of the customer is not in agreement with other indicia used.

Where the vendor cannot regard the customer as a business customer, because, for example, the customer cannot provide a valid VAT number or digital certificate, this might lead to the presumption that it is a private customer and VAT should be charged accordingly.

Establishing the jurisdiction of a private customer

28. In order to make the right tax decision for a supply to a private customer, a vendor must determine the jurisdiction of the customer. Verification of the private customer jurisdiction cannot be grounded in a single and simple mechanism such as an identification number. This means that revenue authorities should be encouraged to provide more certainty through clear public guidance.

Declaration of the customer

29. It is clear that customer self-declaration, when used as the only means of determining the jurisdiction would have limited reliability. The obvious limitation is that the customer can change their declaration to achieve the outcome that they desire if it is not possible to independently confirm the information provided. In some jurisdictions a false declaration by a customer may be an offence under the laws of the country. If this is the case it is recommended that business provide appropriate warnings to customers to this effect. Nevertheless, information provided by the customer (jurisdiction and detailed address) may be regarded as an important element to determine jurisdiction in association with a range of other criteria consistent with business practice and the importance of the transaction.

Payment information

30. A possible method of determining the status or jurisdiction of a customer could be via the payment mechanism. For example, if the customer paid by credit card would it be possible to use card information to identify the customer's jurisdiction?

31. Based on current evidence it is unlikely that credit card information will always be of assistance in determining the jurisdiction of a customer in the short term. Nevertheless, the development of new security technologies and payment systems should be kept under review. Other payments methods – *e.g.*, by bank transfer – may supply useful confirmatory data.

32. Where confirmation of the billing address is requested as part of the commercial processing of an on-line transaction, it would however be reasonable to expect a very high level of correlation with the customers declared taxing jurisdiction.

Tracking/Geolocation Software

33. Geolocation technologies use various information sources to determine the location of an Internet user based on the user's Internet Protocol (IP) address. In recent court cases Internet experts have claimed that technologies achieved 85% accuracy.

34. To determine jurisdiction from an IP number, the destination IP number is compared to a database of geographically known IP numbers. Varying degrees of accuracy (up to 96%) are claimed for such systems, which are increasingly being used by Internet businesses for targeting advertising and for some fraud control purposes. IP number tracing is readily available in many common computer operating systems and in inexpensive software for most common computer platforms.

35. The advantage of technology-based verification is that it is likely to be easily and relatively cheaply incorporated into online transactions.

36. Clarification or agreement between the relevant revenue authority and the business sector as to what rules should be applied in the scenario where an instance of a customer's self declaration of jurisdiction does not match the jurisdiction indicated by a verification technology or system is desirable. The solution should seek to strike an appropriate balance between the genuine concerns of business regarding lost sales, their need for tax certainty and the need for protection of the consumption tax revenue base by governments.

Nature of the supply

37. Another possible source of evidence to ascertain the jurisdiction of the customer can be based on the features of the supply. A combination of features including language, content and currency may assist in providing indications of the intended destination of a supply.

Digital Certificates

38. From a technical point of view, digital certificates offer the best possibilities in the long term, but the use of digital certificates is even less widespread among private customers than among businesses. Consequently, this should only be considered as a long-term solution.

Conclusions

Taking into account the prevailing technologies, the recommended approach at this time is to obtain a customer declaration with the full address of usual place of residence substantiated by other indicia or verification tools, according to the nature, type, scale and quantum of the transaction.

Information provided by the customer (jurisdiction and detailed address) may be regarded as an important element to determine jurisdiction in association with a range of other criteria. Other criteria that may be used by a vendor to substantiate the declaration of the customer include payment information, tracking/geolocation software, nature of the supply, and digital certificates.

Revenue authorities should consider providing additional domestic guidance as to how to tax a transaction where a customer's self declaration of jurisdiction does not match the jurisdiction indicated by other indicia.

Periodic Review

39. The technology that supports e-commerce can change very quickly. Any method used to determine the status and jurisdiction of a customer may rapidly be superseded by developments. Therefore it is suggested that this issue be kept under periodic review.

40. One development that should be monitored is the Universal User Profile whereby a user's passwords and other identity information are stored with a service provider to facilitate easy access to a range of websites and services. Microsoft.NET Passport, AOL's Magic Carpet and the Liberty Alliance are examples of these developments. 'Verified by Visa' and 'MasterCard's SPA' initiatives also provide merchants with tools to verify customer identity. These effectively replace the real world signature with a password. While it is unclear whether these solutions could provide jurisdictional information, further monitoring of Universal User Profile solutions, should be undertaken.

41. By following the suggestions contained in this paper, revenue authorities and businesses will establish a framework in which there is an explicit, but not onerous, process to obtain information from the customer for the vendor to make a reasonable tax decision, consistent with any other data used obtained for commercial or other purposes.

42. The actual details of how the information is obtained, by question and answer, provision of digital certificate or other means is a variable element which sits inside the framework and which can be adjusted to keep pace with technology.

43. In considering changes to the information it is suggested that revenue authorities always seek to move closer to a 100% accurate answer to the questions of status and jurisdiction and that they use means which are, wherever possible, in common commercial practice or which are otherwise not onerous for businesses to adopt.

Summary of Conclusions – Recommended Approaches

44. It should be noted that these conclusions refer to low-value transactions where the vendor does not have an established relationship with the customer. The guidance should be seen as minimum requirements in the absence of better information or solutions available to the vendor.

Recommended approaches to overall verification issues

- Revenue authorities should provide guidance to business on the nature and type of verification that is required to determine the status and jurisdiction of a customer.
- Revenue authorities should consider the nature, type, scale and quantum of revenue applicable to each transaction when developing guidance, to ensure that the administrative response is weighed against the costs of compliance for business and the revenue at risk.

Recommended approaches to establishing and verifying the status and jurisdiction of the business customer

- Where a vendor and customer do not have an established trading relationship, a customer declaration, supported by criteria such as on-line verification of registration numbers, computation systems, payment system data, nature of the supply, and digital certificates may be used to confirm that the customer is registered for consumption tax in their country of origin.
- The jurisdiction of the business customer should be ascertained in the same way, at the same time as its status. When the customer is proved to be an entity with a valid foreign VAT number, this should be accepted as verification of jurisdiction.
- It is suggested that revenue authorities consider providing additional domestic guidance as to how to tax a transaction where a customer's self-declaration of jurisdiction does not match the jurisdiction indicated by other indicia.
- Where the vendor cannot regard the customer as a business customer, for reasons such as the customer not providing a valid VAT number or digital certificate, or absence of other supporting indicia, this might lead to the presumption that it is a private customer.

Recommended approaches to establishing the jurisdiction of a private customer

- Information provided by the customer (jurisdiction and detailed address) may be regarded as an important element to determine jurisdiction in association with a range of other criteria.
- Other criteria that may be used by a vendor to substantiate the declaration of the customer include payment information, tracking/geolocation software, nature of the supply, and digital certificates.
- It is suggested that revenue authorities consider providing additional domestic guidance as to how to tax a transaction where a customer's self-declaration of jurisdiction does not match the jurisdiction indicated by other indicia.



Periodic Review

- Revenue authorities are encouraged to continue to monitor technology and business developments that may assist in the determination of customer jurisdiction.