As a further step in the government-business dialogue on the consumption tax aspects of electronic commerce, the Working Party No. 9 Sub-group on Electronic Commerce is inviting comments from the Consumption Tax TAG and the Technology TAG on the attached WORKING (THIRD) DRAFT of the Report which WP9 will be submitting to the Committee on Fiscal Affairs (CFA) in January 2001. The joint meeting of the WP9 Sub-group and the Consumption Tax TAG (with the Co-Chairs of the Technology TAG) on Wednesday, 18 October 2000, is specifically designed to allow for an exchange of views on the draft Report.

This draft is for the personal use of TAG members and should not, please, be circulated more widely.

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NOTE BY THE SECRETARIAT

1. As a further step in the government-business dialogue on the consumption tax aspects of electronic commerce, the Working Party No. 9 Sub-group on Electronic Commerce is inviting comments from the Consumption Tax TAG and the Technology TAG on the attached working draft of the Report which WP9 will be submitting to the Committee on Fiscal Affairs (CFA) in January 2001. The joint meeting of the WP9 Sub-group and the Consumption Tax TAG (with the Co-Chairs of the Technology TAG) on Wednesday, 18 October 2000, is specifically designed to allow for an exchange of views on the draft Report. The Sub-group will then be developing the draft further and submitting, in mid-November, a final draft to Working Party No. 9 in advance of its meeting on 30 November-1 December 2000.

2. It is important to stress that:

- As with previous papers volunteered by the Sub-group, this draft is for the personal use of TAG members and should not, please, be circulated more widely; and

- The draft Report is “work in progress” and does not reflect a final and agreed position of the Sub-group (or of course the Working Party). It will necessarily be subject to further development and revision, both to take account of business comments and to reflect further thinking in the Sub-group and Working Party.

3. The primary aim in exposing the draft Report to the TAGs at this stage is to invite (of the business participants in particular) views upon:

- The overall tenor and balance of the Report, particularly as it seeks to integrate the views of both the Sub-group and the TAGs.

- The main conclusions and recommendations (Section II), particularly those that seek to reflect the position of the business community as represented on the TAGs.

- The supporting analysis (Section III), again particularly where that seeks to reflect business views/concerns/priorities; and

- Areas for future work (Section IV).

Put another way, looking at the draft in the round, does it adequately and fairly reflect the views of the business community (as represented on the TAGs)? Are there aspects of the draft that need to be clarified or amplified? Are there additional points that the business community feel should feature in the draft? If so, what and where? Views on future work priorities, and how the business community can best support such work are particularly invited.

4. Formally, the final Report next January will be that of WP9 to the CFA. But the aim of the Sub-group (and the Secretariat) in developing the draft is to ensure that it offers a balanced picture of the dialogue with the business community undertaken over the past 18 months.
THIRD DRAFT

CONSUMPTION TAX ASPECTS OF ELECTRONIC COMMERCE:

A REPORT FROM WORKING PARTY NO. 9 ON CONSUMPTION TAXES
TO THE COMMITTEE ON FISCAL AFFAIRS

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I. Context and rationale for concerted approach

II. Main conclusions and recommendations
   A. Guidelines on the definition of the place of consumption
   B. Recommendations on collection mechanism options
   C. Related issues
      − International administrative co-operation
      − Dialogue with business and non-members
      − Opportunities for simplification
      − Further work
      − Publication of report

III. Supporting analysis and arguments
   A. Place of consumption
   B. Tax collection mechanisms
   C. Compliance and administrative co-operation issues
   D. Simplification
   E. Evaluation of the TAG process

IV. Areas for further work

ANNEX

Annex I: Consumption Taxation of Cross-Border Services and Intangible Products in the Context of E-commerce: Guidelines on the Definition of Place of Consumption; and Recommended Approaches to the Practical Application of the Guidelines on the Place of Consumption
I. CONTEXT AND RATIONALE FOR CONCERTED APPROACH

Context

1. The Committee on Fiscal Affairs’ current Programme of Work addressing the taxation aspects of electronic commerce is firmly based on the Ottawa Taxation Framework Conditions, endorsed by Ministers in October 1998.

2. The main conclusions of the Taxation Framework Conditions are:
   - The taxation principles that guide governments in relation to conventional commerce should also guide them in relation to electronic commerce.
   - The CFA believes that existing taxation rules can implement these principles. This approach does not preclude new administrative or legislative measures, or changes to existing measures, relating to electronic commerce, provided that those measures are intended to assist in the application of the existing taxation principles, and are not intended to impose a discriminatory tax treatment of electronic commerce transactions.
   - The application of these principles to electronic commerce should be structured to maintain the fiscal sovereignty of countries, to achieve a fair sharing of the tax base from electronic commerce between countries and to avoid double and unintentional non taxation.
   - The process of implementing these principles should involve an intensified dialogue with business and with non-member economies.

3. In the field of consumption taxes, these elements of the Taxation Framework Conditions were developed as follows:
   - Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place and an international consensus should be sought on the circumstances under which supplies are held to be consumed in a jurisdiction.
   - For the purpose of consumption taxes, the supply of digitised products should not be treated as a supply of goods.
   - Where business and other organisations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms where this would give immediate protection of their revenue base and of the competitiveness of domestic suppliers.
   - Countries should ensure that appropriate systems are developed in co-operation with the WCO and in consultation with carriers and other interested parties to collect tax on the importation of physical goods, and that such systems do not unduly impede revenue collection and the efficient delivery of products to consumers.
Working Party No. 9 Programme of Work

4. Following the 1998 Ottawa Ministerial Conference, a new work programme on consumption tax aspects of electronic commerce was established by Working Party No. 9\(^1\) and approved by the Committee on Fiscal Affairs in January 1999\(^2\), as part of its consolidated work programme on electronic commerce.

Working Party No. 9 Sub-Group on Electronic Commerce

5. To progress these aspects of the post-Ottawa agenda, Working Party No. 9 on Consumption Taxes created\(^3\) a Sub-group on Electronic Commerce\(^4\). Working to a mandate which the Working Party No. 9 approved in February 1999\(^5\), the Sub-group focussed on three major areas of analysis: the practical applications of the principle of taxation in the place of consumption; the analysis of different tax collection mechanisms; and the examination of the possibilities for taxpayer and consumer identification, access to information and administrative simplification.

6. The Sub-group also benefited from the input of two of the five Technical Advisory Groups (TAGs), one considering tax policy and administrative issues (Consumption Tax TAG), the other jointly supervised with the Forum on Strategic Management Sub-group on Electronic Commerce, on technology issues (Technology TAG).

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1. DAFFE/CFA/WP9(99)1/REV1.
2. DAFFE/CFA/M(99)1.
3. DAFFE/CFA/WP9(99)2.
4. The members of the Sub-group are: Australia, Canada (Chair), France, Germany, Ireland, Italy, Japan, Korea, the Netherlands, Sweden, Switzerland, United Kingdom, United States, European Commission and Singapore.
5. DAFFE/CFA/WP9(99)2/REV1.
II. MAIN CONCLUSIONS AND RECOMMENDATIONS

Introduction

7. Based on the detailed analytical work undertaken by its Sub-group on Electronic Commerce, the main conclusions and recommendations of Working Party No. 9 (“Working Party”), at this stage of the process, are set out in paragraphs 8-15 below. Draft guidelines on the place of consumption for the purposes of consumption taxation of cross-border services and intangible products, and recommended approaches to the practical application of the guidelines, are attached as Annex I.

A. Guidelines on the definition of the place of consumption

8. The practical implementation of the Ottawa Taxation Framework Conditions, as they relate to consumption taxation of international cross-border electronic commerce, can indeed be successfully pursued through the application of the principle of taxation in the place of consumption. Whereas existing arrangements in relation to international trade in goods (for example, collection of tax due at importation) adequately meet the needs of governments, there is a specific need to address the international treatment of cross-border trade in services and intangible products, according to the following principles:

i) The application of the Ottawa Taxation Framework Conditions to international trade in services and intangible products can best be achieved by: (1) defining the principle of taxation in the place of consumption more clearly, and (2) identifying collection mechanisms that can support the practical operation of that principle.

ii) This principle should therefore be expressed in the form of OECD “Guidelines on the Definition of the Place of Consumption for Consumption Taxation of Cross-Border Services and Intangible Products”.

iii) Such guidelines should define the place of consumption (and so of taxation) by reference, for business-to-business (B2B) transactions, to the location of the recipient’s business presence, and, for business-to-consumer (B2C) transactions, by reference to the recipient’s usual place of residence. Further work is required on appropriate means of verifying the latter. The Working Party has developed a draft of such guidelines (see Annex I, Part A).

B. Recommendations on collection mechanism options

9. At this stage, the most viable collection mechanisms to support the practical application of such guidelines lie:

i) In a reverse charge or a self-assessment mechanism for B2B transactions; and

ii) In some form of registration-based mechanism for B2C transactions. The latter has its shortcomings (see paragraph 13 below) and there is a recognised need to promote simplified approaches to registration of non-resident suppliers.
The Working Party has developed draft recommendations on the practical application of the principle of taxation in the place of consumption (see Annex I, Part B).

10. In the medium term, particularly in the context of collection mechanisms for B2C transactions, technology-based options (of which there are several variants, including some which would rely on a trusted third party) offer genuine potential. More detailed examination of this potential, and how best governments might support and utilise it, is an important field of further work which the Working Party recommends that it should undertaken in 2001.

C. Related issues

International administrative co-operation

11. The dramatic growth in cross-border e-commerce presents new international challenges for indirect tax authorities, underlining, in particular, the need for substantially greater levels of international administrative co-operation. Drawing upon work undertaken to date, the Working Party intends to examine this issue in more detail during 2001 and to identify practical steps that can be taken and/or promoted to enhance such administrative co-operation.

Dialogue with business and non-members

12. The dialogue with the business community and non-members, as part of the post-Ottawa process, has proved valuable. Such dialogue should continue as part of ongoing work on selected issues. The business community is broadly supportive of the emerging conclusions in this Report (particularly in relation to the definition of place of consumption and the possible use of self-assessment/reverse charge mechanisms for B2B transactions) but remains concerned about the potential compliance burdens that a registration model for B2C transactions might entail.

Opportunities for simplification

13. The Working Party recognises the important role that simplification can play in addressing business concerns, minimising compliance costs and reducing administrative costs. In terms of B2B transactions the endorsement of a reverse charge/self-assessment approach results in significant simplification for suppliers. Additionally, the Working Party recognises the advantages of some form of simplified approach to registration as advocated by the business community. It recognises too the desire of the business community to see some practical steps toward simplification of some elements of the international indirect tax regime (for example, facilitation of cross-border electronic invoicing). A number of such options for simplification have been identified and require further work. The Working Party recommends that it undertake such work (in close co-operation with the business community) to prioritise simplification options and to identify those that require and merit co-ordinated international action to facilitate their effective operation.

Further work

14. The Working Party recommends that further work be undertaken in several fields. These include:

i) Practical means of verification of the declared place of residence in B2C transactions [in the context of paragraph 8 iii) above].
ii) The relative feasibility of technology-based collection mechanisms (paragraph 10 above).

iii) Practical measures to promote international administrative co-operation (paragraph 11 above).

iv) Simplification options and initiatives (paragraph 13 above).

v) The longer term possibility of the evolution of technology-based mechanisms toward systems that would deal with not only services and intangible products but with a larger set of transactions \((i.e.)\) goods and services more generally), and so provide a more comprehensive solution for both business and governments.

Publication of report

15. Subject to the CFA’s approval, the Working Party recommends that this report should be published, as a public discussion draft. The Report would also benefit from the discussion at the Montreal Global Conference, “Tax Administrations in an Electronic World”, in early June 2001. Taking account of such additional inputs, and in the light of further dialogue with business, Working Party No. 9 would then revise the report to reflect definitive proposals and recommendations and submit it to the Committee at the end of June 2001.
III. SUPPORTING ANALYSIS AND ARGUMENTS

Introduction

16. The discussion in this section relates only to consumption taxes at the national level. Sub-national tax regimes were recognised but not considered in detail. Attention may be given to these issues, in the international context, by authorities responsible for consumption tax systems.

17. This report focuses on cross-border supplies of services and intangible products capable of delivery from a remote location, on the basis that the existing tax mechanisms adequately deal with the taxation of goods and need no further development or clarification at this stage.

A. Place of consumption

Context

18. The Taxation Framework Conditions concluded that the consumption tax rules for cross-border electronic commerce trade should result in taxation in the jurisdiction in which consumption takes place. Taxation at the place of consumption promotes certainty and prevents double taxation or unintentional non-taxation where two jurisdictions employ non-compatible place of taxation rules (i.e. at source and destination). Equally important, tax at the place of consumption will ensure neutrality within and amongst conventional and electronic forms of commerce.

19. The Taxation Framework Conditions also directed revenue authorities to work through the OECD to identify concrete steps to implement the Taxation Framework Conditions and to consider the feasibility and practicality of those steps, including: reaching agreement on a definition of the place of consumption, and internationally compatible definitions of services and intangible products. The result of this analysis has been distilled into guidelines on the definition of the place of consumption for cross-border services and intangible products.

Analysis

20. The place of consumption for the cross-border supply of conventional goods (e.g. a compact disk) can be based on the recipient’s address for delivery. If tax is not otherwise payable then appropriate customs systems can collect tax on the importation of physical goods without unduly impeding revenue collection and the efficient delivery of products to consumers. Moreover, due diligence by the supplier and verification by revenue authorities is relatively simple.

21. In contrast, where products are digitally downloaded or electronically delivered via the Internet, there is no physical delivery address for the supplier to rely upon and this therefore has the potential to create difficulties for revenue authorities as well as for suppliers (e.g. proving “exports”).

22. Services may be broadly categorised as those that are either tangible, where the place of consumption can be readily identified, or those that are intangible, where the place of consumption may be
uncertain. While this categorisation is not a technical one, it helps to illustrate how, in relation to certain supplies, difficulties in determining the place of consumption can arise.

23. Examples of **tangible services** include services relating to specific areas of land, including buildings (estate agents, hotel accommodation, and architects); transport (including related services such as handling); and services relating to physical performance (sporting events, concerts, hairdressing services, and restaurants). Each of these services are either physically performed or take place at an identifiable location and may therefore be said to be consumed at that location. Therefore, determining the place of consumption for tangible services can often be defined as the jurisdiction where the service is actually performed.

24. Examples of **intangible services** include: consultancy, accountancy, legal and other “intellectual” services; banking and financial transactions; advertising; transfers of copyright; provision of information; data processing; broadcasting; and telecommunications services. These services cannot readily be seen to be physically performed or to take place at a particular location and are often deemed to be consumed where the provider or customer is located. Any services capable of electronic delivery (including many of those above) are similarly intangible and therefore represent a challenge in defining a practical consumption test. Others types of supplies will, no doubt, be developed as technology advances.

25. The Working Party’s work to date has mainly focused on the issue of taxing intangible services and products set against the Taxation Framework Condition of taxation at the place of consumption. Taxation at the place of consumption should, from an international point of view, lead to an equivalent burden of consumption taxes on the same products in the same market. The business members of the Consumption Tax TAG agree on this principle. With that perspective in mind, identifying an efficient definition of consumption was key to this task.

**Pure definition of consumption**

26. Under a pure consumption test, intangible services would be defined as consumed in the place where the customer actually consumes or uses the services (irrespective of the contract, payment, beneficial interest, or the location of the supplier or customer at the time of the supply). With a pure definition of consumption, tax should in principle accrue to the country in which the actual consumption takes place – for all transactions, whether business-to-business or business-to-consumer.

27. However, the global nature of e-commerce, combined with the mobility of present day communications, puts in question the practicability of a pure consumption test. For example, a US business contracts with a UK business customer to provide consultant services to its branches in Japan. Consumption could be said to take place in the United Kingdom where the customer’s headquarters is located because the services are of benefit to the whole business, or alternatively, consumption could take place at each branch in Japan because the services are actually used there. As a second example: French business contracts with a Canadian business to provide electronically delivered services. The staff of the Canadian business use portable computers and receive the services all over the world. Consumption would take place in whichever country the staff member actually uses the services.

28. A pure place of consumption test would result in a significant, and in some cases an impossible, compliance burden for vendors (e.g. determining the exact place consumption and valuing consumption in

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6. In this context, “business-to-business” means transactions involving not only commercial entities but also other entities that are obliged to register and account for tax, or to be identified for tax purposes.
multiple jurisdictions) and administrative difficulties for tax authorities (i.e. identifying and verifying taxable supplies).

**Practical alternatives for defining place of consumption**

29. The Working Party confirmed that the required approach should take account of the consumption principle while both ensuring certainty for businesses and tax administrations and avoiding distortion of competition through double or unintentional non-taxation. In particular, compliance burdens should be kept to a minimum and the approach should allow for easy and efficient collection by tax administrations. Unless collection burdens are kept to a minimum, compliance will suffer.

30. For B2B transactions, the Working Party reviewed a number of alternatives including the location of the supplier’s profit-generating operations, place of contract, location of the customer, or location of the supplier or the recipient’s business. In the latter case, the location, or “business presence”, of the recipient would be an establishment with the human or technical resources required to receive and utilise the supply. This might include the headquarters, a branch, a registered office, or a seat of economic activity. Yet another approach would be to tax services where they are performed, but where they are performed in more than one place, the provider’s location would be the deemed place of taxation.

31. For B2C transactions, a number of options were identified, including the recipient’s permanent address or usual place of residence, centre of vital interests, and where he/she is a national. The Working Party recognised the supplier would need to be able to identify the location and tax status of his private customer with ease and certainty. It is unlikely, however, that a provider would ever have sufficient information to determine the private customer’s “centre of vital interests” or nationality.

**Emerging conclusions – place of consumption**

**Business-to-business transactions**

32. In terms of B2B transactions, Working Party No. 9 confirms the benefits of treating intangible services as consumed where the recipient has located its business presence. The business members of the Consumption Tax TAG agree with that option, which appears to them workable and well grounded in existing practices. Where there is a choice of locations, such as a headquarters in one country and a branch in another, the business presence should be considered as the establishment (headquarters, registered office or branch of the business) of the recipient that receives and utilises the supply. A “use or enjoyment” test may be appropriate to ensure that the business structure or the mobility of communications is not used to avoid taxes by routing services through temporary establishments in non-tax or low-tax jurisdictions. The business members of the Consumption Tax TAG underlined the importance of the contract in determining the applicable taxing jurisdiction.

**Business-to-consumer transactions**

33. Working Party No. 9 concludes that a guideline based upon the jurisdiction in which the customer has his/her usual place of residence is the most practicable, albeit not the most theoretically pure, definition of “place of consumption” for B2C transactions. Where a consumer has more than one country of residence the place of consumption should be the jurisdiction in which they spend the majority of their time. The business members of the Consumption Tax TAG consider the concept of treating the customer’s normal residence as the place of supply as a significant step in achieving neutrality between e-commerce transactions and conventional forms of transactions.
Verification

34. Having established the place of consumption for private consumers the Working Party focused on the practicalities of determining and verifying this structure. It is important to stress that some type of verification is necessary even in circumstances where the intangible service or product is not subject to tax in the jurisdiction of the customer. In these cases the supplier may have to provide proof of “export” in order to relieve the supply of tax. This led to an analysis of a number of approaches/proxies for usual jurisdiction of residence including: jurisdiction of residence as declared by the recipient to the supplier; country of residence as evidenced by credit card information; a personal tax identification number declared by the recipient to the supplier; and identification of source server/Internet service providers. The options were assessed in terms of simplicity for business and consumers, certainty of application, effectiveness (i.e. whether the option would accurately reflect the place of consumption) and technological feasibility.

35. The determination of residency in the context of online transactions is not without difficulty. The actual level of verification required by tax authorities may vary depending on the nature of the transaction. In some instances, there may still be a billing address (e.g. for a subscription service) to which a statement or bill is sent. In many cases a recipient will self-identify their country of residence (e.g. by way of pull-down menu). However this is unlikely to be sufficient for the purposes of tax authorities if the recipient can readily present false identification and/or such misidentification cannot be detected by vendors with a reasonable level of certainty. In the short term, since most payments for online transactions are made by credit card, the issuing bank data or billing addresses could be envisaged as possible indicia of the jurisdiction of the consumer. Detailed work on the feasibility of such validation, based on a dialogue with representatives of the credit card industry, is continuing.

36. In the medium term, as new technology develops, other indicia could well emerge, such as digital certificates or use of chip cards. It is also recognised that payment methods for online transactions may evolve (for example, through the development of e-cash) which will have a bearing upon the verification of consumer data.

B. Tax collection mechanisms

Context

37. The Taxation Framework Conditions also led the Working Party to develop and consider the feasibility and practicality of options to ensure the effective administration and collection of consumption taxes within the context of e-commerce. The results of the Working Party’s work in this area are set out in recommendations rather than guidelines. This reflects the fact that, unlike the place of consumption, countries may choose different collection mechanisms without creating international distortions in the marketplace.

Analysis

38. The Working Party focused on five tax collection mechanisms, including self-assessment/reverse charge, registration of non-residents, tax at source and transfer, withholding by financial institutions, and technology-based solutions. Each of the collection mechanisms was evaluated in terms of its feasibility of implementation, its effectiveness in capturing imported services and intangible services and products, its compliance burden for businesses, and its administrative burden for governments. In undertaking its analysis of these options, the Working Party benefited greatly from the advice of the Technology TAG which helpfully undertook a parallel exercise of evaluation from a specifically technological perspective.
i) **Self assessment / reverse charge**

39. Under a self-assessment or reverse charge system, recipients would be required to determine the tax owing on imports of services and intangible property, and to remit this amount to the domestic tax authority. Where currently in use for B2B transactions (in most OECD countries), the system has proven feasible, effective, and carries a low compliance and administrative burden. Self-assessment/reverse charge, however, has not been effective in ensuring the collection of tax on supplies made to private recipients.

40. The business members of the Consumption Tax TAG expressed their strong endorsement of “self-assessment/reverse charge” as a model for B2B transactions. The Technology TAG identified no technology-specific issues with such a model. For B2C transactions, however, the Technology TAG concluded that self-assessment was the least practical option from a technology perspective.

ii) **Registration**

41. Registration of non-residents obliges non-resident businesses to register in a jurisdiction and to charge, collect and remit the consumption tax to that country. For the most part this option is feasible, effective and would promote neutrality. Difficulties arise in terms of identifying non-resident suppliers, as well as in imposing registration requirements and enforcing obligations on non-residents. This option could increase the cost of tax administration (e.g. registering, auditing, collections, etc.). Registration would also impose significant compliance costs on non-resident suppliers, particularly for those making supplies in multiple jurisdictions with relatively few sales in each jurisdiction. This latter problem, however, can be addressed via thresholds.

42. The Working Party studied the advantages and disadvantages of registration thresholds for B2C transactions on the basis of competitive equity between domestic and non-domestic suppliers, and the compliance burden imposed on private sector stakeholders. The Working Party examined three types of consumption tax thresholds: thresholds for registration, thresholds for distance selling, and thresholds for simplified taxing and/or reporting requirements.

43. Thresholds ensure that the compliance burden is eliminated where it would reduce or negate the incentive to carry on business activity, e.g. for SMEs. Thresholds may also ease compliance by excluding businesses (not necessarily small ones) on the basis that they make only a limited number of supplies into the jurisdiction. This is particularly important where the aggregate of that activity may significantly contribute to the jurisdiction’s economy. Additionally, thresholds can act to reduce the administrative burden, by permitting tax administrators to focus resources where the return is likely to be high. The principal disadvantage of registration thresholds, however, is the risk to neutrality/competitive equity between taxpayers below and above the threshold.

44. The Working Party recognised that the threshold model is fairly well established internationally. It is likely that tax administrations will choose to take a similar approach to e-commerce. In light of this, the Working Party recommends that Member countries accept the principle that domestic thresholds in place should apply at least as favourably to cross border e-commerce suppliers. This option is consistent with the Taxation Framework Conditions and ensures neutrality of tax treatment and competitive equity between domestic and non-domestic suppliers.
iii) Tax at source and transfer

45. The Working Party also examined the tax at source and transfer option as a tax collection alternative that would reduce the significant compliance costs associated with the registration option. A business would collect consumption tax on “exports” to non-residents and remit the amount to their domestic revenue authority where it would be forwarded to the revenue authority in the country of consumption. The significant increase in the cost of administration, in addition to the need for international agreements regarding enforcement, collection and revenue transfers, places the feasibility of this option in question, at least in the short to medium term. From a purely technological perspective, the Technology TAG advised that such a collection mechanism was feasible, although they acknowledged the scale of international agreement amongst governments that such an approach would necessitate. A variation on the model, to which the Technology TAG also drew attention, would be the introduction of a trusted third party to undertake the collection function(s). But this variant begged its own set of significant questions, such as how the costs would be met/shared, and how revenues would be assured.

46. The potential compliance burdens associated with a mechanism based upon registration of non-residents were a particular concern of the business members of the Consumption Tax TAG. Such burdens might stem simply from the volume of registrations required (assuming sales into a large number of jurisdictions); or from associated hard costs (such as a requirement to appoint a fiscal representative). The business members of the Consumption Tax TAG thus urged governments to consider steps by which such registration requirements could be very substantially minimised (see paragraph 52 below). The Technology TAG, echoing concerns about compliance costs for business, pointed out that there were some (technology-based) steps that governments could take to facilitate business and minimise costs. An example of such support lay in the availability of on-line, Internet-based data sources (such as on tax liability and rates). Such initiatives on the part of governments had a key role to play in supporting several of the possible collection mechanisms.

iv) Withholding by third parties

47. Additionally, the Working Party considered an entirely new system where financial intermediaries (e.g. banks, credit card companies) would be enlisted to collect consumption taxes on payments between recipients and suppliers of digital supplies. The financial intermediary would then remit the tax to the country of consumption. Adopting this system would involve significant start up costs and fundamentally change the operation of most consumption tax systems. The Working Party recognised that the system could be effective but the question remained focused on the feasibility of shifting the onus of collection onto financial institutions.

v) Technology-based options

48. Finally, there was significant discussion about various technology-based solutions to tax collection. One such approach would involve the use of tamper-proof software, which would automatically calculate the tax due on a supply and remit (through a financial intermediary or a trusted third party) the tax to the destination jurisdiction. Bilateral agreements would provide for the verification by the tax authority in the source jurisdiction (on behalf of the destination jurisdiction) of the installation and operation of such software. Private sector software providers would be best positioned to develop the software. The Working Party recognised that this type of approach, in principle, could be an option for the longer term, particularly as an alternative to registration.

49. The business members of the Consumption Tax TAG stressed that technology should not be relied on, of itself, to provide “solutions” to the issues facing tax authorities, although technology might
assist in developing alternative tax collection mechanisms in the future. The business members of the TAG also expressed the views that, over the longer term, a coherent option might emerge from a combination of the elements studied by the Working Party. In other words, there might be a role for third parties, for tax authorities in the jurisdiction of the vendor, as well as for supporting technology.

50. For its part, the Technology TAG similarly encouraged governments not to regard the models examined as mutually exclusive, and to explore possible hybrids which would draw from different models. So, for example, on the basis of the options considered to date, the Technology TAG’s own favoured approach, from a technological perspective, would be a version of the tax at source and transfer/trusted third party model. The Technology TAG further advised that any steps taken in the short term should avoid compromising longer-term opportunities. If possible they should even support the latter, for example, by providing for a limited initial implementation of a particular method. Finally, the Technology TAG underscored the importance of continuing to work closely with business groups, to tease out, for example, the risks and opportunities associated with models based on the use of trusted third parties.

vi) Simplified interim approach

51. In the short to medium term, the business members of the Consumption Tax TAG felt that only the registration (B2C) and self-assessment/reverse charge (B2B) options were practicable, although the long-term viability of the former was questionable.

52. In relation to registration the business members of the TAG proposed a “simplified interim approach” to registration as the best short-term approach for B2C transactions. Business TAG members argued that simplicity would be the key element in encouraging high levels of compliance. To this end they suggested (electronic) registration including only very basic data (e.g. name, address and nature of business). In addition, they stressed that the tax reporting requirements should be both simple and clear – including a straightforward calculation e.g. jurisdictional revenues x tax rate. A key aspect of the approach would be that recovery of input tax would not be available. Normal, full registration, including a full return with input tax recovery, would remain available to interested businesses. The business members of the TAG felt that if the registrant acted in good faith and demonstrated a reasonable effort to determine the country of consumption without success, the registrant should not be held liable. Similarly, they suggested tax authorities should expect good faith and the best efforts by the business to comply with the rules, and in return the authorities should respect the reports filed by registrants.

53. Many of the Working Party members expressed concerns that the voluntary system under the proposed “interim approach” discussed in the preceding paragraph – with obligations limited to “good faith” on the part of the registrant – would have implications for the credibility of the tax regime, and indeed for neutrality as between the compliant and non-compliant businesses. Nevertheless, the Working Party saw a great deal of merit in pursuing a form of simplified registration as suggested by the business members of the TAG. More work on the specifics is required.

Emerging conclusions – tax collection mechanisms

Business-to-business transactions

54. The Working Party welcomes the endorsement by the business members of the Consumption Tax TAG of the self-assessment/reverse charge model for B2B transactions. Consistent with the Taxation Framework Conditions, Working Party No. 9 recommends that in cases where the supplier is not registered or required to be registered under existing mechanisms for B2B transactions, countries should pursue a
reverse charge or self-assessment system in order to protect both revenues and the competitiveness of domestic suppliers.

**Business-to-consumer transactions**

55. The Working Party’s work on collection mechanisms identified the merits and the drawbacks of each of the alternative tax collection mechanisms. Moreover, the Working Party explored possible approaches to rectifying the deficiencies with each option. Nevertheless, in the short term, for B2C transactions, there is *no single option* that is without significant difficulties. That said, in the short term Working Party No. 9 recommends for B2C transactions pursuing a system of simplified registration for non-resident suppliers, which ensures that the potential compliance burden is minimised, consistent with the effective collection of tax. In the medium to long term a move towards technology-based options should be envisaged, and further detailed work should be undertaken in 2001 to assess their relative feasibility and to identify what steps should be taken internationally to promote and/or facilitate them.

56. In so far as the recommended approach to tax collection involves two different models (one for B2B, and one for B2C) there is a related need to provide appropriate means for suppliers to distinguish between the two types of customers. For B2B transactions, most obviously, it will be necessary to confirm the “business” status of the customer so as to justify export exemption by the supplier. Working Party No. 9 recognises that a variety of approaches can be adopted to this practical question, with the distinction being based on suitable criteria acceptable to the relevant tax authorities. Such criteria might be a VAT registration number, a certificate of tax status issued by the tax authority of the recipient country, or other information available as part of the transaction (*e.g.* name of the type of entity).

C. **Compliance and administrative co-operation**

**Context**

57. The Taxation Framework Conditions asked revenue authorities to minimise compliance costs for taxpayers and administrative costs for tax authorities as far as possible. At the same time, they recognised the need to minimise the potential for tax evasion and avoidance, while keeping counter-acting measures proportionate to the risks involved.

58. Implementation of any necessary compliance measures should not only be designed to reduce the risk of revenue loss but also, at the same time, to avoid distortion of competition to the detriment of voluntary compliant taxpayers.

59. The Taxation Framework Conditions also concluded that revenue authorities should maintain their ability to secure access to reliable and verifiable information on taxpayers, improve the use of existing bilateral and multilateral agreements for administrative assistance, and develop international mechanisms for assistance in the collection of taxes.

**Analysis**

60. The Working Party concluded that, even if data limitations prevent an accurate and timely estimate of the revenue risk associated with the growth of e-commerce, it is possible, with reasonable assumptions, to narrow the focus to imported taxable digitally delivered products and services purchased by consumers. It is less likely that businesses might seek to avoid consumption taxes on these types of purchases because most would be able to receive an input tax credit/deduction and/or the benefit of being
able to claim the purchase as an expense to reduce reported taxable income. Examination of the currently available products on the Internet aimed at private consumers suggests that an estimate of potential revenue at risk would not be large in relation to overall consumption tax revenues. However, it is important not to underestimate the competitive implications of a failure to capture these transactions within the system.

61. The Working Party also noted that the compliance tools or steps that could be taken were dependent on which tax collection mechanisms are adopted. For B2B transactions, the use of a reverse charge or other self-assessment mechanisms would significantly decrease the risk of tax evasion and avoidance. For tax collection mechanisms which also involve a conditional zero-rating of “exported” supplies of services and intangible goods, some compliance tools have been examined. This led to an analysis of possible indicia of the customer’s place of residence such as credit card information, personal identification number or identification of source server/internet service provider. The impact of compliance software produced by the private sector was also discussed, as well as technology-based options for tax collection mechanisms.

62. The business members of the Consumption Tax TAG highlighted the fact that such compliance models centred all responsibility and liability on the supplier. They encouraged governments to consider mechanisms which would assign responsibility for different aspects of compliance to the different parties involved in the transactions, including the customer. They also stressed the need to keep the system as simple as possible, adapted to the different kind of businesses, with the minimum compliance burden, in order to encourage voluntary compliance.

63. The Working Party and the business members of the Consumption Tax TAG broadly shared the overall assessment of the potential role of technology in supporting collection and compliance models. The role of technology should be creatively examined, recognising that in some instances such technology would itself need the active support of governments (for example, through the availability of on-line data on liability and rates).

64. Another aspect of the wider compliance debate is the recognised need for a strengthening of international administrative co-operation. The Working Party noted the emergence of the technical instruments to allow timely and secure exchange of information between tax authorities. It also recognised that a better utilisation of existing administrative co-operation instruments could contribute to alleviating the compliance burden of businesses and improving the effectiveness of tax administration, including within the context of international risk management methods/policies.

**Emerging conclusions – compliance and administrative co-operation**

**Compliance**

65. For B2B transactions, Working Party No. 9 concludes that adoption of a self-assessment/reverse charge collection mechanism substantially addresses the main compliance challenges in this field.

66. For B2C transactions, Working Party No. 9 recognises that ensuring effective compliance is less easy. A realistic balance must be sought between the needs of tax authorities and the interests of business (in terms, for example, of speed of transaction, and compliance costs). This is particularly important in relation to the degree of verification of the status and declared place of residence of the consumer. In this area, further work is required to confirm an acceptable mechanism.
Administrative co-operation

67. There is an evident need to strengthen international administrative co-operation between tax authorities. Working Party No. 9 recommends that the existing legal instruments for administrative co-operation be further evaluated, specifically in the context of the growth of electronic commerce and the various tax collection mechanisms which have been examined. It recognises the close relationship between efficient and effective co-operation among tax authorities and the possible implementation of some of the alternative tax collection mechanisms given that some of the latter would necessitate a very strong level of administrative co-operation.

D. Simplification

68. Simplification has emerged as an important theme running through much of the Working Party’s work on the consumption tax aspects of electronic commerce. It has been clearly and consistently identified by the business community (through the Consumption Tax TAG, but also more generally) as a priority concern. The business community argues that simplification of certain selected elements of indirect tax regimes is a key means toward removing potential tax-related barriers to the development of cross-border e-commerce and in turn toward facilitating compliance. With simplification, business argues, comes increased levels of voluntary compliance, reduced compliance costs for business, and, as a logical corollary, reduced administrative costs for governments.

69. In the first instance, it is important to recognise that endorsement of the reverse charge/self-assessment approach in the context of B2B transactions delivers significant simplification. As a result, non-resident vendors who deal exclusively with business customers and who are not required to be registered under existing mechanisms will have few, if any, additional obligations arising from consumption taxes.

70. Therefore, the issue of simplification for non-resident business arises in two contexts: for those businesses that deal with private consumers and for those businesses that are established in more than one jurisdiction. As outlined in paragraph 52 the business members of the Consumption Tax TAG proposed a “simplified interim approach” to registration. This merits serious consideration.

71. The Working Party also considered other simplification initiatives presented by the Consumption Tax TAG. These included:

- Facilitation of electronic invoicing, through a standardisation of invoice formats and associated procedures – to be based, ideally, on an OECD-brokered “model” (drawing, perhaps, on current work within the European Community).

- Facilitation and promotion of electronic VAT reporting/record-keeping systems more generally, to be supported by government – again, if possible, with an OECD “standard”.

- Standardisation of audit requirements, and ideally procedures, employing new technology wherever possible.

- Introduction of an on-line mechanism, supported by government, whereby businesses could check the validity of VAT registration numbers.

- Abolition of requirements, for non-resident businesses, to appoint fiscal representatives and/or post security (bank guarantees).
Standardisation of the tax (VAT/GST) return, in terms of the core fields of data required, and of associated procedures (such as electronic filing and storage) – again based on an OECD “model”, and/or recommendations.

Consideration of mechanisms to provide for advance binding VAT rulings, for simplified arbitration procedures to resolve disputes between tax authorities (e.g. as to where the tax is due), and of the possibility of extending the OECD international competent authority procedures to include consumption taxes.

72. The breadth of these suggestions means that it will be important for the Working Party to prioritise such options and initiatives and to take a realistic view as to what can and should best be pursued at the international level through further OECD-led work. The Working Party concurs with business on the greater relevance of practical procedural steps to make voluntary compliance more likely. It welcomes too the recognition by the business community that some of their suggestions are by their very nature for the longer term (where, for example, they would require international negotiations as such). This underlines the need to take a view as to relative priorities.

**Emerging conclusions - simplification**

73. Working Party No. 9 recognises the key role of simplification in the facilitation of compliance, and in addressing business concerns more generally. It notes too that in many instances the initiative necessarily lies at the national (domestic) level, and that there are inherent limitations upon what can realistically be achieved at the international level. That said, the Working Party recommends that it undertake an evaluation (in close co-operation with the business community) of the relative feasibility of options so as to identify those which can either be promoted internationally (for example in terms of recommended good administrative practice) or require further concerted development through the OECD.

**E. Evaluation of the TAG process**

[Short section to be added to support main conclusion (paragraph 12), i.e. importance of dialogue; value of business input; non-members, again useful but needs strengthening; some process points, e.g. business better at responding to papers, preference for face-to-face meetings, varied levels of active participation, and some suggestions for how the process can be improved and further developed.]
IV. AREAS FOR FURTHER WORK

[Section to be finalised at a later stage. But as a minimum to include short explanatory paragraphs on identified areas for further work, *i.e.*:

- Practical means of verification of the declared place of residence in B2C transactions.
- The relative feasibility of technology-based collection mechanisms.
- Practical measures to promote international administrative co-operation.
- Simplification options and initiatives.
- The longer term possibility of the evolution of technology-based mechanisms toward systems that would deal with not only services and intangible products but a larger basket of transactions, and so provide a more comprehensive solution for both business and governments.]
ANNEX I:

CONSUMPTION TAXATION OF CROSS-BORDER SERVICES AND INTANGIBLE PRODUCTS IN THE CONTEXT OF E-COMMERCE

A. Guidelines on the Definition of the Place of Consumption

Introduction

1. In 1998, OECD Ministers welcomed a number of Taxation Framework Conditions relating to the consumption taxation of electronic commerce in a cross-border trade environment, including:
   
i) In order to prevent double taxation, or unintentional non-taxation, rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.
   
ii) For the purpose of consumption taxes, the supply of digitised products should not be treated as a supply of goods.
   
iii) Where businesses acquire services and intangible property from a non-resident vendor, consideration should be given to the use of reverse charge, self-assessment or other equivalent mechanism.

2. The Guidelines below are intended to achieve the practical application of the Taxation Framework Conditions in order to prevent double taxation or unintentional non-taxation, particularly in the context of international cross-border electronic commerce. Member countries are encouraged to review existing national legislation to determine its compatibility with these Guidelines and to consider any legislative changes necessary to align such legislation with the objectives of the Guidelines. At the same time, Member countries should consider any control and enforcement measures necessary for their implementation.

Business-to-business transactions

3. The place of consumption for cross-border supplies of services and intangible products that are capable of delivery from a remote location made to a non-resident business recipient should be the jurisdiction in which the recipient has located its business presence.

4. Countries may however apply a use and enjoyment test where the application of the approach in paragraph 3 would lead to a distortion of competition or avoidance of tax.

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1. This will normally include a “taxable person” or an entity who is registered or is obliged to register and account for tax. This may also include another entity that is identified for tax purposes.

2. The “business presence” is, in principle, the establishment (headquarters, registered office, or a branch of the business) of the recipient that receives and utilizes the supply.
Business-to-private consumer transactions

5. The place of consumption for cross-border supplies of services and intangible products that are capable of delivery from a remote location made to a non-resident private recipient\(^4\) should be the jurisdiction in which the recipient has their usual place of residence.\(^5\)

Application

6. In the context of value-added or other general consumption tax systems, these Guidelines are intended to define the place of consumption (and so the place of taxation) for the international cross-border supply of services and intangible products by non-resident vendors/suppliers that are not otherwise required to register or are not required to register in the destination jurisdiction under existing mechanisms.\(^6,7\)

7. These Guidelines apply to the cross-border supply of services and intangible products, particularly in the context of international cross-border electronic commerce, that are capable of delivery from a remote location.

8. The Guidelines do not, therefore, apply to services which are not capable of direct delivery from a remote location (for example hairdressing, repair of tangible goods, transportation or vehicle rental). Nor are they applicable in circumstances where the place of consumption may be readily ascertained, as is the case where a service is performed in the presence of both the service provider and the customer, or when the place of consumption can more appropriately be determined by reference to a particular criterion (for example, services related to particular immovable property or goods). Finally, it is recognised that specific types of services, for example, telecommunications services, may require more specific approaches to determine their place of consumption.

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3. Such a test should normally only be applied in the context of a reverse charge or self-assessment mechanism.

4. In other words, a “non-taxable person” or an entity not registered or not obliged to register and account for tax.

5. It is recognised that implementing this guideline will not always result in taxation in the actual place of consumption. Under a “pure” place of consumption test, intangible services are consumed in the place where the customer actually uses the services. However, the mobility of communications is such that to apply a pure place of consumption test would lead to a significant compliance burden for vendors.

6. While these guidelines are not intended to apply to sub-national value-added and general consumption taxes, attention will need to be given to the issues presented, in the international context, relating to these taxes.

7. The objective is to ensure certainty and simplicity for businesses and tax administrations, as well as neutrality via equivalent tax implications for the same products in the same market (i.e. avoiding competitive distortions through unintentional non-taxation).
B. Recommended Approaches to the Practical Application of the Guidelines on the Place of Consumption

Introduction

1. Three tax collection mechanisms are typically used in consumption tax systems: registration, reverse charge/self-assessment and collection of tax by customs authorities on importation of physical goods. Under a registration system, the vendor of goods and services registers with the tax authority and, depending on the design of the tax, either is liable to pay the tax due on the transaction to the tax authority, or collects the tax payable by the customer and remits it to the tax authority. Under the reverse charge/self-assessment system, the customer pays the tax directly to the tax authority. The third approach, collection of the tax on the importation of physical goods by customs authorities, is common to virtually all national consumption tax systems where national borders exist for customs purposes.

2. Since registration and self-assessment/reverse charge mechanisms are currently in use in the majority of consumption tax systems, they represent a logical starting point in determining which approaches are most appropriate to apply in the context of electronic commerce transactions involving cross-border supplies of services and intangible products.

3. While emerging technology promises to assist in developing innovative approaches to tax collection, and the global nature of electronic commerce suggests that collaborative approaches between tax authorities will become increasingly important, Member countries agree that in the short term, the two traditional approaches to tax collection remain the most promising. However, Member countries agree that their application varies depending on the type of transaction.

Recommended approaches

Business-to-business transactions

4. In the context of cross-border business-to-business (B2B) transactions (of the type referred to in the Guidelines), it is recommended that in cases where the supplying business is not required to be registered for consumption tax in the country of the recipient business, a self-assessment or reverse charge mechanism should be applied where this type of mechanism is consistent with the overall design of the national consumption tax system.

5. In the context of business to business cross-border transactions in services and intangible products the self-assessment/reverse charge mechanism has a number of key advantages. Firstly, it can be made effective since the tax authority in the country of consumption can verify and enforce compliance. Secondly, given that it applies to the customer, the compliance burden on the vendor or provider of the service is minimal. Finally, it reduces the revenue risks associated with the collection of tax by non-resident vendors whether or not that vendor’s customers are entitled to deduct the tax or recover it through input tax credits.

6. Member countries may also wish to consider dispensing with the requirement to self-assess or reverse charge the tax in circumstances where the customer would be entitled to fully recover it through deduction or input tax credit.
**Business-to-consumer transactions**

7. Effective tax collection in respect of business-to-consumer (B2C) cross-border transactions of services and intangible products presents particular challenges. Member countries recognise that no single option, of those examined as part of the international debate, is without significant difficulties. In the medium term, technology-based options offer much potential to support new methods of tax collection. Member countries are expressly committed to further detailed examination of this potential to agree on how it can best be supported and developed.

8. In the interim, where countries consider that the non-collection of tax on services and intangible products makes it necessary (for example because of the potential for distortion of competition or significant revenue loss) a registration system (where consistent with the overall design of the national consumption tax system) should be considered to ensure the collection of tax on B2C transactions.

9. Where countries feel it appropriate to put into effect a registration system in respect of non-resident vendors of services and intangible products not currently required to be registered for that country’s tax, it is recommended that a number of considerations be taken into account. Firstly, consistent with the effective and efficient collection of tax, countries should ensure that the potential compliance burden is minimised. For example, countries may wish to consider registration regimes that include simplified registration requirements for non-resident suppliers, possibly combined with limitations on the recovery of input tax in order to reduce risks to the tax authority. Secondly, in order to ensure parity of treatment, thresholds for registration should be given careful consideration. Finally, Member countries should consider appropriate control and enforcement measures to ensure compliance, and recognise, in this context, the need for enhanced international administrative co-operation.