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VERIFICATION OF THE PLACE OF CONSUMPTION FOR ELECTRONIC COMMERCE TRANSACTIONS: POSSIBLE USE OF CREDIT CARD INDICIA

Annexes containing Credit card Companies’ Initial Comments, and Responses to the WP9 Sub-group Note

Background

1. A more-detailed dialogue between representatives of major credit card companies and the OECD was initiated on 12 June 2000 with a letter sent to Mr. Jeffrey Owens, Head, Fiscal Affairs concerning consumption tax issues relating to electronic commerce. This letter was sent by Mr. Spencer Schwartz, Vice President of Taxation, MasterCard International. Visa International EU also contributed to the debate by submitting (in early August) their comments on some of the collection, assessment and verification methods and mechanisms currently being considered. These letters are in Annex I.


3. Representatives from credit card companies (including American Express Company) have, to date, submitted individual responses¹ to this note. These responses are in Annex II.

¹. MasterCard and American Express submitted their response jointly.
Letter from MasterCard International to Jeffrey Owens, 12 June 2000

Dear Mr. Owens:

It has been some time since we last met over lunch last year in Palo Alto, California. However, I have been monitoring the work being performed by the OECD Technical Advisory Groups (TAGs). I am writing to you today regarding the work currently being performed by the Consumption Tax and Technology TAGs. The purpose of this letter is to provide MasterCard International’s position on certain consumption tax issues relating to electronic commerce. I trust that you will forward this document to the appropriate parties on the Consumption Tax and Technology TAGs. We appreciate the opportunity to comment on these very important tax issues.

The Consumption Tax TAG, with technological input from the Technology TAG, is considering several options for future collection of consumption taxes. One of the options being considered involves withholding by financial institutions and several of the other options involve financial institutions providing certain information about cardholders. I would like to offer MasterCard’s general comments on these options.

Withholding by financial institutions

The TAGs are considering a withholding tax system administered by financial intermediaries that would collect the consumption tax applicable in the jurisdiction of consumption and remit the tax directly to the appropriate tax authority. The TAGs are considering whether such an approach is feasible from a business and technological perspective.

MasterCard appreciates the concern of global tax authorities regarding the ability to collect consumption tax that is properly due within their jurisdiction. However, a withholding requirement such as that described above raises several issues.

We do not believe that a system of withholding by intermediaries can be effectively mandated on a cross-border basis, where the intermediaries are not resident in the jurisdiction asserting the tax. In addition, in the electronic commerce context, a system that seeks to mandate withholding by a particular class of intermediaries, such as financial institutions, may drive customers away from those institutions in favor of new, perhaps less accountable intermediaries, such as unaccounted digital cash systems. Therefore, any system premised on withholding by intermediaries will need to be market driven and should not be mandated on any intermediary or class of intermediaries (such as financial institutions). Companies should volunteer to become withholding intermediaries (or “Trusted Third Parties”) based on market driven commercial viability. A market driven system is also essential to create the necessary incentives for all of the parties involved.

Privacy concerns, such as the EU requirements, could impede the intermediary and supplier’s ability to provide information regarding the transaction and the consumer. Risk of becoming subject to legal liabilities for matters such as privacy issues, regulatory issues and the collection and remittance of incorrect tax amounts may also inhibit companies’ willingness to become withholding intermediaries.
All of the information necessary for a withholding intermediary to collect and remit the proper amount of tax is not currently available. This includes real-time updated and accurate information in every jurisdiction for taxability/classification of the product or service, merchant information, customer information, exemptions, jurisdiction of consumption, registration, etc. Technology does not currently exist to enable any party to properly gather all of this information. Therefore, a technology-based solution would have to be developed. However, the current rules underlying many of the necessary determinations are too unclear and complex to facilitate technological solutions. Such a solution, if possible, should not be discussed until all of other concerns are properly addressed (e.g. privacy concerns and tax simplification).

Any technological solution implemented by companies in the payments industry may also significantly slow the performance of the networks that facilitate customer checkout (e.g. the card authorization process). This would raise serious business concerns to those in the payments industry.

Also being discussed by the TAGs is whether the withholding intermediary would be responsible for meeting audit requirements of the various tax authorities. Neither MasterCard nor its member financial institutions have sufficient resources to meet the audit requirements of tax authorities in every jurisdiction in the world.

**Possible other roles for financial institutions**

The TAGs are also considering whether financial institutions could play a role in authenticating customer information. They are considering whether financial institutions could permit access to their databases by other parties to enable these parties to perform crosschecks between information supplied by a customer and such things as cardholder billing addresses. This would raise significant concerns for MasterCard and its member financial institutions, including, but not limited to, operational performance, security, privacy, legal risk, unfair competition and regulatory issues.

**Global consensus**

As you know, electronic commerce has no boundaries and is becoming a global market. Therefore, we believe that it is essential for an international consensus to be reached on any tax solution for cross-border transactions. This is particularly important to avoid double taxation while minimizing administrative burdens for both taxpayers and tax authorities.

We appreciate the opportunity to comment on these important issues. Please let me know if you have any questions or if we can be of further assistance.

Sincerely,

Spencer Schwartz
Vice President of Taxation
MasterCard International Incorporated

Visa International EU (Visa) appreciates this opportunity to comment on one of the working documents currently being discussed in the OECD’s Technology TAG.

Visa follows the progress of debate on electronic commerce and tax in the OECD with great interest and appreciates the great amount of effort and innovation which is being put into developing solutions for these rather complex issues.

General comments

Visa’s primary objective in this debate is to ensure that the collection, assessment and verification methods and mechanisms developed for the virtual environment will be neutral in terms of the payment method chosen in an e-commerce transaction. The methods and mechanisms chosen should be technology neutral and apply equally to all transactions regardless of the method of payment.

It is a widely accepted concept that e-commerce legislation should be technology neutral. The speed at which the technical development in e-commerce evolves supersedes by far the speed at which regulators are able to act, and thus regulators should make sure that, unless clearly intended, the outcome of the legislative process should not be sector or technology specific.

Whether a transaction is taxable or not and the determination of the rate at which it is taxable should not depend on whether a specific payment method is being used. Such an approach will put the existing well established brands at a great disadvantage and ultimately may push consumers towards using alternative, and less accountable means of payment in order to avoid paying VAT.

Specific comments

Credit Card Issuer Identification Numbers or Bank Identification Numbers (BIN numbers) which is the Visa terminology have been developed as a tool for identifying the issuer of a specific card. BIN numbers are also used to identify the settlement, billing and authorization currenc(y)ies used by a particular bank. The information contained in the ISO Register is e.g. used as a tool for tracking down the owner of a particular BIN number in case of transaction problems, etc.

2. About Visa International

Visa International EU is the European Region of Visa International. Visa is the world’s leading payment brand and the largest payment system worldwide with more volume than all other major payment cards combined. Visa plays a pivotal role in advancing new payment products and technologies to benefit its 21 000 member financial institutions and their cardholders. Visa has more than 80 smart card programs in 35 countries and on the Internet, with 23 million Visa chip cards, including eight million Visa Cash cards. Visa pioneered the development of SET Secure Electronic Transaction which has been piloted in over 200 countries. There are over 1 billion Visa, Visa Electron, Interlink, PLUS and Visa Cash cards, which generate more than US$1.5 trillion in annual volume. Visa-branded cards are accepted at over 18 million worldwide locations, including at more than 550 000 ATMs in the Visa Global ATM Network. Visa’s Internet address is www.visa.com.
The Visa BIN numbers follow the ISO/IEC 7812 Standard. What is important to stress is that the Visa BIN numbers which are listed in the ISO Register are listed as Visa International BIN numbers and not as BIN numbers of individual Visa Member banks i.e. all Visa International BIN numbers are listed with one and the same address. This also applies to the other major payment schemes and, consequently, the ISO Register will not reveal the location of the issuing bank of the most widely used international payment cards.

In general, it is important to keep in mind that BIN numbers were not developed for, or intended for, identifying specific cardholders in terms of place of residence or jurisdiction and are in fact not used for any such purposes today. As further exemplified below Visa do not regard BIN numbers to serve as an accurate means of determining the jurisdiction of a consumer in terms of determining the relevant VAT rate for an e-commerce transaction.

Cardholders move around while maintaining a relationship with the same bank. In some border regions consumers tend to shop cross-border for payment cards because of differences in fees applied. With e-commerce and Internet banking the access to services such as obtaining a payment card increases and more cardholders will hold payment card issued in several different countries. In these or similar situations the BIN number would not give any indication as to the actual jurisdiction of the cardholder. Furthermore, if certain BIN numbers were to be associated with lower costs i.e. that specific payment cards give access to goods or services with little or no VAT added the demand for such cards would rise.

Banks already do cross-border issuing of payment cards from their country of establishment into other markets and are expected to increase this activity further. In such an instance the BIN number used for cross-border issuance may also be used for domestic issuance. Within the next year several new forms of multi-currency and multi-country issuance of payment cards under on a single BIN number will become a reality. The BIN number used would still serve as the identifier code of the Issuer, however, the cardholders will be located in several different countries.

For further clarification or information please contact Peter Møller Jensen at Visa International EU, Brussels Office, Rue du Luxembourg 3, 1000 Brussels. Telephone +32 2 501 08 45.
ANNEX II: RESPONSES FROM CREDIT CARD COMPANIES

Response from MasterCard International and American Express Company, 1 September 2000

We have been discussing with others in the payments industry proposals that credit card information be used to verify the place of residence of an on-line purchaser in order to determine the tax aspects of transactions. In particular, we have reviewed the note dated August 2000 entitled “OECD: Working Party No. 9 Sub-group on E-Commerce - Verification of the Place of Consumption for Electronic Commerce Transactions: Possible Use of Credit Card Indicia”.

While the issues raised in the note are quite complicated and far-reaching, we have some initial concerns regarding both the feasibility and the appropriateness of using credit card information in the manner outlined in the note. In addition to issues such as privacy that the note itself identifies, our concerns include the following:

The note assumes that credit cards are and will in the near future be “the dominant (if not exclusive) form of payment for consumer transactions over the Internet.” To the extent that other forms of payment exist today or may develop in the future, an approach that focuses on only one means of payment could lead to distortion and lack of neutrality by influencing consumers in their choice of payment method. We also believe that reliance on a single approach for all credit card transactions can cause marketplace problems in light of different systems and operational practices used by the various card issuers and networks.

The note “relies on the hypothesis that the credit card user and issuer reside in the same jurisdiction.” Our own experience today confirms that it is not unusual for a credit card issuer to be located in a country other than the residence of the cardholder. Such cross-border issuance of cards is likely to become more common because of factors such as more liberalized regulation governing the cross-border provision of financial services, the consolidation of financial institutions through cross-border mergers, the elimination of separate currencies with the advent of the Euro, and the creation of a single market for financial services in the European Union.

The note appears to assume that information card issuers have regarding the billing address of their card holders could be readily made available in a timely fashion to determine taxability at the point of sale. Our understanding is that this is not the case today. As recent experience in addressing “Y2K” issues indicates, a problem that may appear to be superficially simple can in fact require significant and expensive resources to address.

We look forward to participating with others in a dialogue to explore these issues in more depth in the near future.

[...]

We respectfully request and would greatly appreciate it if the Technology TAG would not move forward with its proposed report until they have fully understood and considered the concerns of the payments industry. We would like to discuss these concerns in more detail during the proposed conference call noted above.

Richard P. Romeo
Vice President - General Tax Counsel
American Express Company

Spencer Schwartz
Vice President of Taxation
MasterCard International Incorporated
Response from Visa International, 1 September 2000

On behalf of Visa International, I take the liberty of submitting comments regarding the most recent discussion paper from the OECD Working Party No. 9 [Sub-group on Electronic Commerce] dated August 2000 regarding the possible use of credit card indicia for verification of the place of consumption.

I would like to thank the [Sub-group] for giving us this opportunity of commenting on the present discussion paper. While we do appreciate the great efforts, which are being put into developing solutions to these rather complex issues we do, nevertheless, feel it is necessary to stress some of the concerns raised by the discussion paper.

In our position paper dated 1 August, 2000 we have already addressed most of the questions raised. A copy of this paper is attached for easy reference.

Firstly, we feel it is appropriate to stress the fact that any method chosen for tax collection or assessment would have to be neutral in terms of the method of payment chosen.

The OECD Working Group paper is, quite rightly, based on the presumption that payment by card is the most predominant way of paying for transactions over the Internet today, but also in the years to come. The same presumption is stated in the explanatory memorandum to the proposal for amending the 6th VAT Directive, however, it is also stated that the dominance of credit cards will change once the other payment systems mature. We fear that an approach in relation to the tools chosen to determine the jurisdiction of the consumer for VAT purposes, which does not maintain neutrality in terms of the payment method used may in fact ignite such a shift on the wrong basis.

Secondly, the paper relies on the assumption that the various card payment systems are built in similar ways. A wide variety of payment systems are in existence today which differ in their respective structure e.g. some systems are four party systems (cardholder, issuer, merchant, acquirer) while others are three party systems (cardholder, issuer/acquirer, merchant). The differences in structure also means differences in the information available, or data exchanged between the parties involved. Whether certain data is available or not, or where it is available, will depend on the particular system and product.

As stated in the document, data-protection issues will arise under the Data Protection Directive in relation to using the billing address as a means of verifying the jurisdiction of the consumer, since the billing address would fall under the definition of “personal data” in the Directive.

Lastly, whether or not a particular country is to be regarded as a “tax haven” will depend local laws and VAT rates and may comprise a much wider range countries than what is normally referred to as “tax havens”.

All in all, we do feel that reaching any conclusion on the current basis would be premature. The technical, legal and business implications raised by the issues relating to taxation and e-commerce are still not fully understood by the parties involved, including governments and e-commerce is still not fully developed. We therefore urge the OECD to further consult with all the parties involved before reaching any final conclusions.

We hope we will be able to continue in the debate surrounding these issues.

Sincerely yours,

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