



CONSUMPTION TAX ASPECTS OF ELECTRONIC COMMERCE

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

February 2001

DRAFT FOR PUBLIC COMMENT

Deadline: 30 April 2001

NOTE BY THE SECRETARIAT

1. This report details the work of the Working Party No. 9 on Consumption Taxes over the past two years on the consumption tax aspects of electronic commerce. **The Working Party's principal conclusions and recommendations are summarised in Section II of the Report.**
2. The Committee on Fiscal Affairs has:
 - **Endorsed the report**, noting in particular the terms of the emerging conclusions and draft Guidelines.
 - **Approved the publication** of the report for a period of public comment.
 - **Mandated the Working Party** to take forward that work, and to submit to the CFA in June 2001:
 - A summary and review of reactions to this report, particularly following the Montreal Conference (4-6 June 2001).
 - Guidelines, and associated recommended approaches to their application, for formal approval by the Committee.
 - A comprehensive status report on the progress of the further work programme.
3. Comments are invited on this report **before 30 April 2001**, and may be sent to **Mr. Jeffrey Owens**, Head of Fiscal Affairs (daffa.contact@oecd.org).

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I. CONTEXT AND RATIONALE FOR CONCERTED APPROACH

Context

1. The Committee on Fiscal Affairs' (CFA) current Programme of Work addressing the taxation aspects of electronic commerce is firmly based on the Ottawa Taxation Framework Conditions¹, endorsed by Ministers in October 1998.

2. The main conclusions of the Taxation Framework Conditions are that:

- 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. The broad taxation principles which should apply to electronic commerce, as identified in the Taxation Framework Conditions, are:

Neutrality

- i) Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Efficiency

- ii) Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.

Certainty and simplicity

- iii) The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

1. See <<http://www.oecd.org/daf/fa/E-com/framework.pdf>> for a copy of "Electronic Commerce: Taxation Framework Conditions".

Effectiveness and fairness

- iv) Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to the risks involved.

Flexibility

- v) The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.

4. In its work, the Working Party No. 9 on Consumption Taxes (the “Working Party”) has consistently sought to achieve a balance between all these principles. It recognises that there are circumstances in which the principles may compete, and that government and business may have different views on what the balance and priority of their application should be in particular contexts. This underlies the importance of government-business dialogue. The business community places a particular focus on neutrality in certain cases, seeing this as a priority principle which should inform the reading of all the others. The Working Party, while mindful of that particular business focus and determined to foster consensus wherever possible, nonetheless believes it important to give due weight to all the principles, recognising that they form a package.

5. In the field of consumption taxes, the core 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 World Customs Organization (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

6. Following the 1998 Ottawa Ministerial Conference, a new work programme on consumption tax aspects of electronic commerce was established by Working Party No. 9 and approved by the CFA in January 1999, as part of its consolidated work programme on electronic commerce.

Working Party No. 9 Sub-Group on Electronic Commerce

7. To progress these aspects of the post-Ottawa agenda, Working Party No. 9 created a Sub-group on Electronic Commerce.² Working to a mandate which the Working Party approved in February 1999, the Sub-group focussed on three major areas of analysis: the practical application 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. In addition to the core foundation of the Taxation Framework Conditions, the Sub-group drew on the various implementation options identified in the companion document “Electronic Commerce: A Discussion Paper on Taxation Issues”³ (which was also released at the time of the Ottawa Ministerial Conference in 1998).

8. The Sub-group and Working Party 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) advising on technology issues (Technology TAG). This Report reflects the conclusions of the Working Party, and makes specific reference to the input, advice and recommendations of the TAGs. (The reports submitted by the two TAGs are available separately.⁴)

2. The members of the Sub-group are: Australia, Canada (Chair), France, Germany, Ireland, Italy, Japan, Korea, Norway, the Netherlands, Sweden, Switzerland, United Kingdom, United States, European Commission and Singapore.

3. See <<http://www.oecd.org/daf/fa/E-Com/discusse.pdf>>.

4. See <<http://www.oecd.org/daf/fa>> for a link to the “Report by the Consumption Tax TAG” and the “Report by the Technology TAG”.

II. MAIN CONCLUSIONS AND RECOMMENDATIONS

Introduction

9. Based on the detailed analytical work undertaken by its Sub-group on Electronic Commerce, the main conclusions and recommendations of the Working Party, at this stage of the process, are set out in paragraphs 10-17 below. Draft Guidelines on the place of consumption for the purposes of consumption taxation of cross-border services and intangible property, 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

10. The practical implementation of the 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. Existing arrangements in relation to international trade in goods (for example, collection of tax due at importation) currently meet the needs of governments in terms of effective tax collection, although there is a recognised need to maintain efforts to simplify and streamline such systems (so as, in particular, to accommodate the growth in the volume of such traffic). There is, however, a specific need to address the international treatment of cross-border trade in services and intangible property, according to the following principles:

- i) The application of the Taxation Framework Conditions to international trade in services and intangible property 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 Property”. The Working Party has developed a draft of such Guidelines (see Annex I, Part A).
- iii) Such Guidelines should define the place of consumption (and so of taxation) by reference, for business-to-business (B2B) transactions, to the jurisdiction in which the recipient has located its business presence, and, for business-to-consumer (B2C) transactions, by reference to the recipient’s usual jurisdiction of residence. Further work is required on appropriate means of verifying the latter.

B. Recommendations on collection mechanism options

11. 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 the near term (pending adoption of technology-facilitated options), in some form of registration-based mechanism for B2C transactions. The latter has its shortcomings (see paragraph 15 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).

12. 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 and/or the use of digital certificates) offer genuine potential. More detailed examination of this potential, and how best governments can support and utilise it, both to facilitate compliance and simplification, is an important field of further work which the Working Party recommends that it should undertake with urgency in 2001. The Working Party recognises that achieving this is a dynamic process as it would require certain changes in the existing and evolving systems, both in the public and private sectors. The Working Party therefore recognises that in its further work, active co-operation with the business community (developing upon, for example, the advice which has been submitted by the Technology TAG), and with other international groups setting or co-ordinating standards concerning electronic commerce, will be indispensable.

C. Related issues

International administrative co-operation

13. 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 under the auspices of the CFA, 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

14. The dialogue with the business community and non-members, as part of the post-Ottawa process, has proved valuable, particularly in identifying current and emerging business models and practices. 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 recommended use of self-assessment/reverse charge mechanisms for B2B transactions). The business community is concerned to ensure that taxation-related measures do not hamper the growth of electronic commerce, and that they take proper account of such important issues as consumer privacy. It remains concerned about the potential compliance burdens that a registration model for B2C transactions might entail; and the lack, more generally, of technological tools which can immediately and robustly support any of the tax collection models which have been examined. The business community believes that only partnerships with government will lead to viable compliance models that both ensure the integrity of the tax system and are cost effective. It remains committed to continued co-operation with governments to this end.

Opportunities for simplification

15. 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

16. The Working Party recommends that further work be undertaken in several fields. These include:
- i) Practical and effective means of verification of the declared jurisdiction of residence in B2C transactions (in the context of paragraph 10 iii) above).
 - ii) Practical and effective means of verifying the status of the recipient (business/consumer).
 - iii) The role of registration thresholds in minimising compliance requirements of non-resident suppliers.
 - iv) The relative feasibility of technology-based collection mechanisms (paragraph 12 above); and the use of “intelligent networks”, as well as tools and standards (such as XML), to facilitate collection and remittance.
 - v) Practical measures to promote international administrative co-operation (paragraph 13 above).
 - vi) Simplification options and initiatives (paragraph 15 above).
 - vii) Compliance-related issues, in conjunction with the Forum on Strategic Management, focusing on areas of risk to effective tax collection.
 - viii) The longer term possibility of the expansion of technology-based mechanisms toward systems that would deal with not only services and intangible property 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

17. Subject to the CFA’s approval, the Working Party recommends that this report should be published for a period of public review, inviting comments, for example, on the emerging conclusions. 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, the Working Party would then revise the report to reflect definitive proposals and recommendations and submit it to the Committee’s next meeting at the end of June 2001.

III. SUPPORTING ANALYSIS AND ARGUMENTS

Introduction

18. 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 should be given to these issues, in the international context, by authorities responsible for consumption tax systems.

19. This report focuses on cross-border supplies of services and intangible property capable of delivery from a remote location. Existing tax collection mechanisms in place to deal with the taxation of international trade in goods operate effectively, although there is an accepted need to maintain efforts (and, in particular, to support the WCO's work) to simplify and streamline such systems, so as to cope with the significant growth, driven by electronic commerce, in the volume of such traffic.

A. Place of consumption

Context

20. 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 at destination). Equally important, tax at the place of consumption will serve to create a level playing field and is thus more neutral within and amongst conventional and electronic forms of commerce.

21. 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 on internationally compatible definitions of services and intangible property. The result of this analysis has been distilled into Guidelines on the definition of the place of consumption for cross-border services and intangible property.

Analysis

22. 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. (Systems development by, for example, "fast parcel" carriers, are improving this position further.)

23. 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.* corroborating the "export" of a product, and so its exemption from tax).

24. 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 transactions, difficulties in determining the place of consumption can arise.

25. 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.

26. 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. Other types of intangible services will, no doubt, be developed as technology advances.

27. The Working Party’s work to date has mainly focused on the issue of taxing intangible services and property 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

28. 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-business⁵ or business-to-consumer.

29. 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, a 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.

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

5. 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.

consumption in multiple jurisdictions) and administrative difficulties for revenue authorities (*i.e.* identifying and verifying taxable supplies). The Technology TAG has, however, encouraged governments to remain open to a possible shift toward actual place of consumption, particularly in the light of the deployment of third generation wireless and other technological developments that may help, in the medium term, to determine the location of the consumer at the time of an on-line purchase.

Practical alternatives for defining place of consumption

31. 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.

32. 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; and 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 to which the supply is made. 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 location of the supplier would be the deemed place of taxation. In relation to any of these approaches, specific anti-avoidance rules may be required.

33. For B2C transactions, a number of options were identified, including the recipient's permanent address or usual place (jurisdiction) of residence; their 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 their private customer with ease and certainty. It is unlikely, however, that a supplier 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

34. In terms of B2B transactions, the Working Party confirms the benefits of treating intangible services as consumed where the recipient has located its business presence, and so concludes that a Guideline should be framed in these terms. 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 (for example, headquarters, registered office or branch of the business) of the recipient to which the supply is made. In certain circumstances, revenue authorities may use a different criterion to determine the actual place of consumption 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

35. The Working Party 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 jurisdiction of residence as the place of taxation as a significant step in achieving neutrality between e-commerce transactions and conventional forms of transactions. The Technology TAG has highlighted the significant problems which are currently presented in attempting to identify the jurisdiction of a "virtual" customer. It argues that, with the major exception of digital certificates, technology is only likely to be able to determine a consumer's location in the longer term. Hence its support for leaving open the possibility of revisiting, in the longer term, the practical application of the place of consumption for B2C transactions.

Verification

36. 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.

37. The determination of jurisdiction of residence in the context of online transactions is not without difficulty. The actual level of verification required by revenue 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, on its own, is unlikely to be sufficient for the purposes of revenue authorities.

38. In its exploration of the various options by which jurisdiction might be confirmed, the Working Party was advised, in some detail, by the Technology TAG. The latter agreed that none of the technological options were sufficiently accurate to make them viable propositions at this stage, and recommended that the focus should lie on digital certificates as a medium term option which offered the most promise (in that they were in commercial deployment now; had a clear business-driven rationale if not a consumer-driven one; looked likely to develop further as an integral element of applications; and so could well meet taxation-related ends). On the basis of in-depth consultations with representatives of the credit card industry, the Technology TAG found credit card-related information to be inaccurate as evidence of jurisdiction/residence. Pursuit of this option would, in the TAG's view, be disruptive to on-line business transactions, and would only serve to encourage alternative payment methods. The Technology TAG further concluded that the use of Internet provider (IP) number tracing as a proxy for jurisdictional verification had limits in terms of its reliability and capacity to be manipulated (*i.e.* to show an incorrect IP address). That said, some government members of the TAG felt that such avenues were still worth pursuing further, as an interim, if limited, improvement in location information. Business members counselled against this, however, citing concerns about reliability, about the potential impact on transaction times, and about potentially substantial costs of implementation.

39. Business and government members of the Technology TAG and Consumption Tax TAG fully recognise the need to identify a practical short term solution to meet the needs of governments, without negatively impacting upon the ability of business to engage in on-line commerce or imposing unreasonable compliance burdens. Viable interim solutions might well not be technological – for example, they might

rely on the use of a merchant's internal databases, or any publicly or commercially accessible data. Finally, and more generally, the Technology TAG also highlighted increasing consumer sensitivity about personal privacy and data protection, and industry responsiveness to such concerns. Commercial systems design was reflecting these concerns, and businesses were reluctant to seek to collect more information from customers than they needed for commercial purposes. This trend was also showing through in the future development of payment systems. It was important therefore that considerations such as these were fully taken into account by governments as they were exploring the verification issue further.

40. The Working Party recognises that there is no immediate, comprehensive answer to the particular question of verification of jurisdiction for B2C on-line transactions. It recognises too that this sector of e-commerce currently represents a relatively small proportion of total e-commerce, and so accepts that the response to the current "problem" must be proportionate (just as is true for collection mechanisms for this sector). It remains important therefore to seek to identify a practical and pragmatic approach in the near term pending the emergence of more fully technology-enabled methods of such verification. While mindful of the Technology TAG's advice as to the deficiencies of the technological options examined to date, the Working Party nonetheless believes that some further work should be undertaken to evaluate more critically those limitations. In particular, the Working Party wishes to satisfy itself that the limitations are such that they rule out some of the options (such as IP tracing, or credit card indicia) even as interim (and "less than perfect") arrangements. The Working Party intends to undertake this further work (to examine and evaluate various technological and non-technological options in this field) as a priority in 2001, continuing to work very closely with the business community (given, in particular, the concerns which they have registered about potential burdens and costs).

B. Tax collection mechanisms

Context

41. 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 to date are expressed in terms of recommended approaches to the practical application of the Guidelines. This reflects a recognition that, unlike the core place of consumption principle itself, countries may choose different collection mechanisms without creating international distortions in the marketplace.

Analysis

42. The Working Party focused on five tax collection mechanisms, including self-assessment/reverse charge, registration of non-residents, tax at source and transfer, collection by trusted third parties (such as financial intermediaries), and technology-based solutions. Each of the collection mechanisms was evaluated in terms of its *feasibility* of implementation, its *effectiveness* in capturing imported intangible services and property, 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

43. 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 Member 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 transactions involving private recipients (B2C).

44. 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*

45. A registration system would oblige non-resident businesses to register in a jurisdiction and to charge, collect and remit the consumption tax to that country. From an administrative point of view, 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. The Technology TAG expressed particular misgivings about traditional registration-based collection mechanisms, pointing to the current lack of technological tools to support them, and the potential for greater complexity of business systems that registration approaches entailed.

46. 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.

47. Thresholds ensure that the compliance burden is eliminated where it would reduce or negate the incentive to carry on business activity, *e.g.* for small and medium-sized enterprises (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 administrations 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 (although this is not a “new problem” for those revenue authorities that already operate a registration threshold for indirect taxation). For its part, the Technology TAG questioned the practical relevance of registration thresholds, given the lack of accurate technologies to identify B2C sales of digital products into a jurisdiction.

48. 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 registration thresholds should apply in a non-discriminatory manner. Other issues, such as compliance costs for taxpayers and administrative costs for revenue authorities, will also need to be taken into account.

49. 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 which, in addition, was incompatible with e-commerce business models). The business members of the

Consumption Tax TAG thus strongly urged governments to consider steps by which such registration requirements could be very substantially minimised (see paragraph 56 below). The Technology TAG echoed concerns about compliance costs for business, and pointed out that there were some technology-based steps that governments could take to reduce the costs associated with collection models generally. 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 (reflecting a partnership approach) on the part of governments had a key role to play in supporting several of the possible collection mechanisms.

iii) Tax at source and transfer

50. 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, arguing that technology could well be creatively harnessed to facilitate such an approach and address its perceived shortcomings. Administrative costs, for example, could be minimised through the use of “intelligent networks”, which could route payments through to the appropriate revenue authorities. The Technology TAG recommended further work in this field to examine the potential more systematically. 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, for the Working Party, this variant begged its own set of significant questions, such as how the costs would be met/shared, and how revenues would be assured.

iv) Collection by third parties

51. Additionally, the Working Party considered an entirely new system where third parties (such as financial intermediaries) would be enlisted to collect consumption taxes on payments between recipients and suppliers of digital supplies. The third party 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, for example, financial institutions. The Technology TAG likewise argued that the responsibility for collection should not be imposed upon any third party intermediary or set of intermediaries. Any such third party participation should, in their view, be voluntary and based upon market-driven commercial viability, recognising that such a model could be successful if third parties were provided with appropriate incentives.

v) Technology-based and/or technology-facilitated options

52. Finally, there was significant discussion about various technology-based or technology-facilitated solutions to tax collection. One such approach would involve the use of tamper-proof software, which would automatically calculate the tax due on a transaction 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 “supplying” jurisdiction (on behalf of the “consuming” jurisdiction) of the installation and operation of such software. Private sector software providers would probably be best positioned to develop the software, with necessary input from tax administrations. In some instances tax administrations might even choose to take the lead in such development. The Working Party recognised that this type of approach, in principle, could be an option for the medium to longer term, and so

recommends that evaluation of the potential, and relative feasibility, of technology-based and/or technology-facilitated collection mechanisms, as part of the overall tax compliance strategies in this area, should be undertaken as a priority element of further work, commencing early in 2001. Such evaluation should continue to draw on the advice and expertise of the business community.

53. 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 revenue 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 revenue authorities in the jurisdiction of the vendor, as well as for supporting technology. Technology could support any part of the overall compliance model, but the integrity of the tax system overall should be paramount.

54. 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 to combine elements of a global registration, tax at source and transfer and trusted third party models. 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. The Technology TAG concluded that a hybrid/combined approach was the most desirable option, and so recommended that it should be pursued vigorously. 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.

55. Addressing the collection mechanism debate more generally, the Technology TAG underlined that B2C on-line trade was very much in its infancy, and so argued that compliance costs should be very critically assessed in relation to the expected revenue yield: a balance should be sought between the two. In the short term, there would be risks in seeking to implement a collection model without appropriately low compliance costs, not least because of the current limitations of technological tools to support low-cost administration. A consistent theme of the Technology TAG’s advice to governments has been that the latter should only pursue collection “solutions” that serve commercial purposes as well as a tax administration purpose.

vi) *Simplified interim approach*

56. While endorsing self-assessment/reverse charge as a coherent option for B2B on an ongoing basis, in the short term, and without prejudice to the pursuit of longer-term technology-based solutions, the business members of the Consumption Tax TAG felt that, for B2C transactions, only the registration option was practicable, although its long-term viability was questionable.

57. Recognising the current needs of governments to address B2C transactions, the business members of the TAG proposed a “simplified interim approach” to registration as the best short-term interim 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 that non-resident suppliers should be obliged to register through a simplified (electronic) procedure including only very basic data (e.g. name, address and nature of business). Under such a simplified procedure the liability to account for tax would remain with the supplier. 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 in circumstances where such registered businesses acted in good faith and demonstrated a reasonable effort to accurately determine the jurisdiction of consumption, but without success, then the registrant should not be held liable for the tax. Similarly, they suggested revenue 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. Finally, they encouraged revenue authorities to concentrate their efforts on the non-compliant, by using existing instruments and other arrangements for mutual administrative co-operation, and by taking collective responsibility for distributing information about each other's tax obligations so as to inform vendors who are unaware of their obligations in foreign countries.

58. Many of the Working Party members expressed concerns that the 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. 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 to identify how best such an approach can be pursued. This is a priority topic for further work in 2001.

Emerging conclusions – tax collection mechanisms

Business-to-business transactions

59. 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, the Working Party recommends that in cases where the supplier is not registered and is not 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

60. 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 the Working Party 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.

61. 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. The Working Party 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 revenue 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 (such as the very nature of the product being provided). Some further work is necessary in this field to confirm practical criteria which can be applied readily by

business while providing revenue authorities with adequate assurance (for example, of the grounds for relieving an export transaction from tax).

62. Some members of the business community have argued that the limited revenues currently at stake in respect of B2C on-line transactions, combined with the current lack of tools for effective tax compliance and enforcement, make it appropriate to consider application of a zero rate of VAT to such digital transactions for a limited period until such time as a comprehensive technology-based mechanism is developed and deployed. The Working Party cannot support such a proposition. It would introduce a tax-based distortion of competition into the market, by positively discriminating in favour of digital delivery as compared with conventional delivery. This would fundamentally contradict the principle of neutrality. Attempts to overcome that distortion by, in turn, extending the zero rate to equivalent conventional products would represent an unacceptable erosion of the tax base.

C. Compliance and administrative co-operation

Context

63. The Taxation Framework Conditions directed revenue authorities to minimise compliance costs for taxpayers and administrative costs for revenue 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. 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.

64. 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

65. In relation to the estimation of revenue yield “at risk” in the context of e-commerce, the Working Party concluded that it is possible, with reasonable assumptions, to narrow the focus to imported, taxable, digitally-delivered products and services purchased by private 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 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 tax system.

66. The Working Party also noted that the compliance tools or steps that could be taken were very much dependent on which tax collection mechanisms were 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.

67. 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 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.

68. The Working Party and the business members of the Consumption Tax TAG broadly share 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).

69. 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 revenue authorities. It also recognised that a better utilisation of existing administrative co-operation instruments (such as bilateral tax treaties, and the Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters) could contribute to alleviating the compliance burden of businesses and improving the effectiveness of tax administration. It notes too that the business community has emphasised the importance that they attach to governments making progress toward such improved international co-operation.

Emerging conclusions – compliance and administrative co-operation

Compliance

70. For B2B transactions, the Working Party concludes that adoption of a self-assessment/reverse charge collection mechanism substantially addresses the main compliance challenges in this field.

71. For B2C transactions, the Working Party recognises that ensuring effective compliance is less easy. A realistic balance must be sought between the needs of revenue authorities, and the interests of business and customers (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 jurisdiction of residence of the consumer. In this area, further work is required to confirm an acceptable mechanism. The business community stressed the need in their view, when evaluating such mechanisms, to take particular account of the balance between the compliance/collection costs and the actual/forecast revenue yield.

Administrative co-operation

72. There is an evident need to strengthen international administrative co-operation between revenue authorities. The Working Party 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 revenue authorities and the possible implementation of the alternative tax collection mechanisms given that most of the latter would necessitate a very strong level of administrative co-operation.

D. Simplification

73. 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.

74. 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 registered are not required to be registered under existing mechanisms will have few, if any, additional obligations arising from consumption taxes.

75. 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 56 the business members of the Consumption Tax TAG proposed a "simplified interim approach" to registration. This merits serious consideration.

76. The Consumption Tax TAG also presented a number of other simplification initiatives and suggestions. 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, and access to other tax-related data (*e.g.* on liability and rates).
- 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 revenue 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.

77. 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

78. The Working Party 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

79. The close working relationship with business and non-member economies, facilitated through the TAG process, has proved valuable to the Working Party as it has taken forward the post-Ottawa agenda. Business input into the debate has been particularly strong, from both the Consumption Tax TAG and the Technology TAG. The sharing of papers, and joint meetings, proved useful ways of advancing the debate and sparking new ideas and perspectives. Such dialogue, which strengthened and deepened over time, has greatly assisted governments in their examination of the issues. Non-member input has likewise proved valuable, helping to bring a global perspective to the issues under consideration.

80. Notwithstanding some variations in the level of active participation, the TAG process has thus been an important feature of the work programme to date, and should be continued - subject to some refinement in the composition, structure and mandates of the TAGs (which the CFA will be addressing separately). For its part, the Working Party recommends that efforts should be made to strengthen non-member participation in future TAGs, by involving a larger number of countries and encouraging a more active involvement. Business participation might also usefully be reviewed to provide a stronger voice for the interests of SMEs. Finally, TAG participation might also be broadened to bring in other interests/perspectives (such as academics, and consumer representatives).

IV. AREAS FOR FURTHER WORK

81. This Report reflects the status of the Working Party's post-Ottawa work programme as at the end of 2000. As such it is, in part, a report on work in progress. But it is designed too to offer a clear signal of the probable way forward, in the near term, on the principal issues. Publication of the Report, subject to the approval of the CFA, will provide an opportunity for additional comment on the emerging conclusions identified in the Report.

82. The Working Party recognises that further work is required in a number of areas, and recommends that this be pursued actively in 2001. Such further work is necessary in respect of:

- i) ***Verification of the declared jurisdiction of residence of the consumer in B2C on-line transactions*** – to identify practical and effective methods which appropriately balance the needs of revenue authorities with the interests of business/consumers.
- ii) ***Verification of the status of the customer*** – to identify practical and effective options of distinguishing between business and private consumers, which provide sufficient assurance to revenue authorities while minimising specific demands upon business.
- iii) ***Registration thresholds*** – to clarify further the role that they can play in minimising compliance requirements upon non-resident suppliers.
- iv) ***Technology-based and technology-facilitated collection mechanisms*** – to assess their relative feasibility, their potential timeframes, and the role that related standards and tools can play in supporting tax-related functions.
- v) ***International administrative co-operation*** – to identify more clearly the role that this can play in supporting efficient and effective tax administration, and what practical steps can realistically be taken to strengthen and develop such co-operation.
- vi) ***Simplification options and initiatives*** – to evaluate rigorously relative priorities, taking account, in particular, of business views, and to identify those options which merit concerted international action.
- vii) ***Compliance-related questions*** – to identify particular areas of risk in relation to effective assurance and compliance, and to examine any measures that might, as necessary, be adopted to address such risk.
- viii) ***Longer term strategies for exploiting the potential of technology-based mechanisms*** – to assess how such mechanisms might go beyond the immediate concern of international trade in services and digital products, and provide technology-facilitated “solutions” for tax collection in relation to a much larger set of transactions (*i.e.* goods and services more generally). Business-driven initiatives already being pursued in relation to international B2C transactions in goods should be examined in this context.

ANNEX I

CONSUMPTION TAXATION OF CROSS-BORDER SERVICES AND INTANGIBLE PROPERTY 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 property that are capable of delivery from a remote location made to a non-resident business recipient¹ should be the jurisdiction in which the recipient has located its business presence.²

4. In certain circumstances, countries may, however, use a different criterion to determine the actual place of consumption, where the application of the approach in paragraph 3 would lead to a distortion of competition or avoidance of tax.³

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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 (for example, headquarters, registered office, or a branch of the business) of the recipient to which the supply is made.
 3. Such an approach should normally be applied only in the context of a reverse charge or self-assessment mechanism.

Business-to-private consumer transactions

5. The place of consumption for cross-border supplies of services and intangible property that are capable of delivery from a remote location made to a non-resident private recipient⁴ should be the jurisdiction in which the recipient has their usual residence.⁵

Application⁶

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 property by non-resident vendors/suppliers that are not otherwise registered and are not required to register in the destination jurisdiction under existing mechanisms.^{7,8}

7. These Guidelines apply to the cross-border supply of services and intangible property, 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, hotel accommodation, 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 physical presence of both the service provider and the customer (for example, hairdressing), 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, some telecommunications services, may require more specific approaches to determine their place of consumption.⁹

4. In other words, a “non-taxable person” or an entity not registered and *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. In accordance with the Ottawa Taxation Framework Conditions, specific measures adopted in relation to the place of taxation by a group of countries that is bound by a common legal framework for their consumption tax systems may, of course, apply to transactions between those countries.

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

8. 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).

9. When such specific approaches are used, the Working Party recognises the need for further work and for international co-ordination of such arrangements to avoid double or unintentional non-taxation.

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

B. Recommended Approaches to the Practical Application of the Guidelines on the Definition of 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 tangible 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 tangible 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 property.

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 revenue 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 registered and 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 B2B cross-border transactions in services and intangible property 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 or intangible product 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 property 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 it necessary, for example because of the potential for distortion of competition or significant present or future 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 property not currently registered and not 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 (including electronic registration and declaration procedures), possibly combined with limitations on the recovery of input tax in order to reduce risks to the tax authority. Secondly, countries should seek to apply registration thresholds in a non-discriminatory manner. 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.