



ELECTRONIC COMMERCE: TAXATION FRAMEWORK CONDITIONS

*A Report by the Committee on Fiscal Affairs,
as presented to Ministers at the OECD Ministerial Conference,
“A Borderless World: Realising the Potential of Electronic Commerce”
on 8 October 1998.*

*Ministers welcomed the report and endorsed the proposals on how to
take forward the work as outlined within it.*

**THE DRAFT MINISTERIAL REPORT
PREFACE**

This Report has been prepared by the Committee on Fiscal Affairs of the OECD. The Report has benefited from inputs by the European Commission and the World Customs Organisation in the area of indirect taxes and from an exchange of views with the business community.

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ELECTRONIC COMMERCE: TAXATION FRAMEWORK CONDITIONS

A Report by the Committee on Fiscal Affairs

I. Introduction

1. Electronic commerce has the potential to be one of the great economic developments of the 21st Century. The information and communication technologies which underlie this new way of doing business open up opportunities to improve global quality of life and economic well being. Electronic commerce has the potential to spur growth and employment in industrialised, emerging and developing countries.

2. Revenue authorities have a role to play in realising this potential. Governments must provide a fiscal climate within which electronic commerce can flourish, weighed against the obligation to operate a fair and predictable taxation system that provides the revenue required to meet the legitimate expectations of citizens for publicly provided services. Striking the right balance between these objectives is the aim of this Report.

II. Main conclusions

3. The Committee on Fiscal Affairs (CFA) recognises that the technologies which underlie electronic commerce offer Revenue authorities significant new opportunities to improve taxpayer service and Member countries are committed to exploiting fully these opportunities (see Section III).

4. The taxation principles which guide governments in relation to conventional commerce should also guide them in relation to electronic commerce. The CFA believes that at this stage of development in the technological and commercial environment, existing taxation rules can implement these principles.

5. 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.

6. Any arrangements for the application of these principles to electronic commerce adopted domestically and any adaptation of existing international taxation principles 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 taxation and unintentional non taxation (see Section IV). Revenue authorities acting within the OECD or other *fora*, must take an active role in encouraging protocols and standards for electronic commerce which are compatible with these principles.

7. The CFA has been able to reach conclusions on conditions for a taxation framework needed to implement these principles (see Section V). Intensified co-operation and consultation with business will be an important part of the process of implementing these principles (see Section VI).

III. Taxpayer service opportunities

8. Revenue authorities recognise that electronic commerce technologies will open up new ways by which they can undertake their business of administering tax law and collecting tax revenues and new ways by which they interact with the wider community.

Box 1. Taxpayer service opportunities offered by new technologies

Improving service standards

- (i) Communications facilities and access to information can be enhanced to assist taxpayers and to improve response times.

Minimising business compliance costs

- (ii) Tax registration and filing requirements could be simplified and norms promoted for the acceptance of electronic material.

Enhance voluntary compliance

- (iii) Electronic assessment and collection of tax could be encouraged. Easier, quicker and more secure ways of paying taxes and obtaining tax refunds could be facilitated.

IV. The broad taxation principles which should apply to electronic commerce

- 9. Box 2 sets out the widely accepted general tax principles that should apply to electronic commerce.

Box 2. Broad taxation principles which should apply to electronic commerce

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.

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 the taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.

- 10. The full application of the principles set out in Box 2 will require further work after the Ottawa Ministerial meeting.

V. The challenge of implementing these broad principles

11. The challenge facing Revenue authorities is how to implement the broad taxation principles identified in Box 2 in a rapidly changing environment. In a number of areas the CFA has been able to reach conclusions on the elements of a taxation framework that will incorporate these principles. These are summarised in Box 3.

Box 3. Electronic commerce: elements of a taxation framework

Taxpayer service

- (i) Revenue authorities should make use of the available technology and harness commercial developments in administering their tax system to continuously improve taxpayer service.

Tax administration, identification and information needs

- (ii) Revenue authorities should maintain their ability to secure access to reliable and verifiable information in order to identify taxpayers and obtain the information necessary to administer their tax system.

Tax collection and control

- (iii) Countries should ensure that appropriate systems are in place to control and collect taxes.
- (iv) International mechanisms for assistance in the collection of tax should be developed, including proposals for an insert of language in the OECD Model Tax Convention.

Consumption taxes

- (v) 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.
- (vi) For the purpose of consumption taxes, the supply of digitised products should not be treated as a supply of goods.
- (vii) 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.
- (viii) Countries should ensure that appropriate systems are developed in co-operation with the WCO and in consultation with carriers and other interested parties to collect tax on the importation of physical goods, and that such systems do not unduly impede revenue collection and the efficient delivery of products to consumers.

International tax arrangements and co-operation

- (ix) While the OECD believes that the principles which underlie the international norms that it has developed in the area of tax treaties and transfer pricing (through the Model Tax Convention and the Transfer Pricing Guidelines) are capable of being applied to electronic commerce, there should be a clarification of how the Model Tax Convention applies with respect to some aspects of electronic commerce.

12. The CFA also recognises that there are ongoing developments in areas such as establishing electronic trading, payment, certification and technical standards and protocols and in the reform of Internet governance where Revenue authorities both individually and in such international fora as the OECD may need to play a role if they are to succeed in implementing the tax principles set out in Box 2. In addition, Revenue authorities in co-operation with other appropriate authorities, will closely monitor developments in electronic means of payment, particularly unaccounted systems.

13. Recognising the global nature of electronic commerce, Revenue Authorities will intensify their use of existing co-operative arrangements, explore options for multilateral administrative assistance and examine the application of the recommendations relating to geographically mobile activities contained in the OECD Report *Harmful Tax Competition* to the electronic commerce environment.¹

14. The CFA believes that an implementation of the framework conditions set out in Box 3 will enable Governments to harness the opportunities and to respond to the challenges of electronic commerce and thereby lead to an internationally consistent taxation approach to electronic commerce.

VI. The post-Ottawa agenda and process

15. The Turku conference of November 1997 initiated work on developing taxation framework conditions for electronic commerce. The Ottawa Ministerial meeting of October 1998 will take this process further. However, much remains to be done. This Report has identified the broad taxation principles which should apply to electronic commerce and identified implementation issues, including how these new technologies offer Revenue authorities the opportunity to improve the service they provide to taxpayers.

Box 4. The post-Ottawa agenda

Revenue authorities will work through the OECD and in consultation with business to identify concrete substantive steps that can help implement and extend the taxation framework conditions described in Box 3, and to consider the feasibility and practicality of those steps, including the following:

Taxpayer service

- (i) Developing an international consensus on ways to simplify taxation systems to minimise the cost of tax compliance, particularly for small- to medium-sized enterprises.

Tax administration, identification and information needs

- (ii) Adopting conventional identification practices for businesses engaged in electronic commerce.
- (iii) Developing internationally acceptable guidelines on the levels of identification sufficient to allow digital signatures to be considered acceptable evidence of identity in tax matters.
- (iv) Developing internationally compatible information requirements, such as acceptance of electronic records, format of records, access to third party information and other access arrangements and periods of retention and tax collection arrangements.

Tax collection and control

- (v) Designing appropriate strategies and measures to improve tax compliance with regard to electronic commerce transactions, including measures to improve voluntary compliance.

Consumption taxes

- (vi) Reaching agreement on, *inter alia*, defining place of consumption, on place of taxation rules and on internationally compatible definitions of services and intangible property.
- (vii) Developing options for ensuring the continued effective administration and collection of consumption taxes as electronic commerce develops.

1. Luxembourg and Switzerland abstained from the Council recommendation which accompanied this report.

Box 4. The post-Ottawa agenda (continued)

International tax arrangements and co-operation

- (viii) With regard to the OECD Model Tax Convention, clarifying how the concepts used in the Convention apply to electronic commerce, in particular:
 - (a) To determine taxing rights, such as the concepts of “permanent establishment” and the attribution of income; and
 - (b) To classify income for purposes of taxation, such as the concepts of intangible property, royalties, and services, and in particular as regards digitised information.
- (ix) Monitoring of developments in, and tax administration challenges presented by, electronic commerce, in the application of the OECD Transfer Pricing Guidelines.
- (x) Improving the use of existing bilateral and multilateral agreements for administrative assistance.
- (xi) Considering how harmful tax competition for electronic commerce is to be avoided, in the context of the Recommendations on geographically mobile activities accompanying the OECD Report *Harmful Tax Competition*.

16. The Committee on Fiscal Affairs further recognises that the full application of the principles which underlie these arrangements will require further work after the Ottawa Ministerial meeting. It also accepts that any taxation arrangements put in place must be capable of developing as the technological and commercial environment changes. The Committee welcomes the willingness of business to work with Government in developing further approaches for the implementation of these principles and looks forward to working with business at both the technological and policy level. This further dialogue entails a recognition of the place of Revenue authorities as stake holders in electronic commerce and the validity of their involvement in the development of the standards and protocols which are now emerging.

Box 5. The post-Ottawa process

To pursue the post Ottawa agenda, Revenue Authorities will continue to:

- (i) Carry forward the work programme in the Committee on Fiscal Affairs including monitoring developments in, and tax administration challenges presented by, electronic commerce and continuing its close relationship with the European Commission and the World Customs Organisation.
- (ii) Intensify co-operation and regular consultation with the business community.
- (iii) Develop its contacts with interested non-member economies.
- (iv) Report back periodically to the OECD Council and, if appropriate, to Ministers.