



Global Business Dialogue on Electronic Commerce

Taxation Recommendations

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INTRODUCTION

Tax policy will greatly impact the potential growth of the emerging networked economy. To ensure this growth, government and industry must work together to create a tax system that stimulates this digital marketplace. The GBDe recognizes that tax policy must address governments' legitimate need to collect tax revenues to fund public services and eliminate competitive distortions faced by local industries. To find tax solutions that balance these national interests with global realities, the GBDe is committed to participating in government / industry dialogues on this critically important issue on an international, regional and national basis.

BASIC TAX PRINCIPLES

The GBDe recommends that governments rely on the following basic principles as they develop tax policies for the networked economy:

- 1. Neutrality:** Tax policy must not penalize businesses and consumers who choose to conduct transactions electronically rather than through traditional channels of commerce. Goods or services should receive the same tax treatment regardless of delivery method, and compliance burdens and costs should not be heavier for businesses and consumers who conduct business electronically than for those who engage in traditional commerce. Double taxation, double non-taxation (e.g.

instances where consumption taxes applied to a set of transactions where the supply rules inadvertently result in no country having jurisdiction to tax) and other competitive distortions should be avoided.

2. Simplicity: The rules for taxing all forms of commerce, including Internet-enabled transactions, should be simple, clear and easy to apply. Governments must dramatically simplify their tax systems, and ensure that compliance burdens do not discriminate against businesses and consumers who conduct transactions electronically whether within a country or outside of a country. Tax authorities should also take advantage of new technology to reduce the costs of complying with tax rules.

3. Fairness: No single category of e-commerce operators should be penalized by the allocation of tax burdens. The liability for collecting taxes on virtually traded goods should not be forced upon financial intermediaries, providers of electronic infrastructure or other parties who are not liable for taxes on similar conventional transactions. Research should be undertaken to investigate the technical possibilities of developing automated tax systems that would efficiently distribute compliance burdens.

4. Enforceability & Technological Efficiency: The emerging networked marketplace creates difficult enforcement challenges for today's tax systems. The GBDe recognizes the competitive issues that may result and believes that government and industry must take care to develop credible and low cost compliance models to secure effective tax collection. Such models should be reasonable, technologically feasible, and free of undue burdens or economic distortion. The GBDe endorses the ongoing work of the Organization for Economic Cooperation and Development (OECD) to address this issue in a systematic and global fashion.

5. International coordination & consistency: Tax policy worldwide must be coordinated and consistent with a model that can be implemented on a global basis. Again, the GBDe endorses the OECD as an appropriate venue for this coordination to occur. Unilateral action on the part of individual governments should be consistent with OECD guidelines and Model Tax Conventions.

6. A tax framework adapted to the networked economy: Governments should understand the impact of taxation policies on the growth of the networked economy. For instance, one of the most important tools companies have

is the manner in which they compensate employees. Employee participation in companies' profits and value-creation is today indispensable, and equity compensation such as stock options is used by a large number of global enterprises. In this respect, the tax treatment of equity compensation in many countries is a serious concern for companies with global activities. Furthermore, governments should not hinder companies from educating and preparing their employees for the revolutionary changes of the information society.

GLOBAL INDIRECT TAXATION

The GBDe recognizes governments' legitimate right to enforce consumption taxes on transactions involving customers within their borders. In Asia, Latin America, and Europe, most nations currently have some form of national consumption tax that is applied to both online and offline sales. For most electronic commerce transactions, consumption taxes can easily be levied on goods ordered online but physically delivered to consumers. For business-to-business sales there similarly are no substantial compliance concerns. However, when sales occur directly between an online vendor of digital goods (music, video, software, books etc.) in one country and individual consumers in another country, governments will be challenged to collect consumption taxes on these sales and will understandably seek to prevent competitive distortions, ensure a tax-neutral market environment and protect existing revenues.

The GBDe urges the EU, the US and other governments to move forward to create a system that is enforceable, easy to adopt and administer, fair and commercially viable on a global basis. We endorse the ongoing work of the OECD to assist governments in applying globally accepted e-commerce taxation principles to national tax systems and avoiding a patchwork of inconsistent national tax laws or compliance requirements that are not technologically satisfiable today.

AMERICAS

Canada

The Canada Customs and Revenue Agency ("CCRA") has released a discussion paper on the application of its value added tax ("GST") to electronic commerce. The principles are likely to be equally applicable to the sub-national VAT's but not the non-VAT sales taxes.

It is primarily based on OECD principles but has a number of departures, primarily related to the

characterization of items as services versus intangible personal property. A characterization as intangible personal property makes international e-commerce much more difficult. The report was developed with mixed private sector/public sector technical advisory groups. There were a number of non-consensus positions, particularly in this area. The government position appears to lean to a characterization as intangible personal property which would not advance e-commerce.

The report has developed one concept that appears unique to Canada. For the purpose of establishing whether an e-commerce party is carrying on business in Canada, it recommends a "place of operations" test. This requires a facts and circumstances review of a number of factors. While attractive in theory, its application would be difficult and inconsistent with the principle of simplicity. The test includes considering at least ten factors which are not weighted in the report.

The report acknowledges difficulties in meeting OECD standards under current legislation but, surprisingly, makes no recommendations for legislative action.

Those sub-national sales taxes that are not VAT based tax a fairly limited range of services. One area they do often deal with is computer services. This area is particularly difficult. The largest jurisdiction imposing such a tax has commenced a review of its law in this area.

United States of America

In the United States, the policy focus has been on whether remote vendors (i.e., vendors that do not have a physical presence in a particular state) should be obligated to collect and remit sales and use taxes for the benefit of states in which they sell goods to consumers but otherwise have no physical presence. A vendor currently is only obligated to collect and remit sales taxes on sales to customers in states in which the vendor has a physical presence because of a U.S. Supreme Court decision that said such an obligation would pose an unconstitutional burden on interstate commerce, due in part to the complexity created by differing state and local sales tax laws.

State governments, concerned about the potential loss of revenue from remote sales, have urged the United States Congress to require that remote vendors, including those doing business via the Internet, collect and remit sales and use taxes in all states. To date, the U.S. government has taken a wait-and-see approach to this issue - it appointed an advisory commission which was unable to achieve sufficient support for any formal

recommendations, and therefore passed a moratorium on the imposition of new or discriminatory taxation of electronic commerce. This moratorium does not address or change current rules governing sales tax collection. The October 2001 deadline for the moratorium's expiration, however, is creating momentum for numerous competing proposals in the U.S. Congress to extend the moratorium and reform state sales and use taxation. The US moratorium on new taxes on Internet access has been continued until November 1, 2003.

The pressure of impending Congressional action has spurred a voluntary state tax reform effort involving over half of the states (the "Streamlined Sales Tax Project" or "SSTP"), which are considering model legislation to simplify and modernize sales and use tax administration.

US sub-national units cannot levy sales and use tax without a substantial nexus because the US Supreme Court has held this to be an unacceptable clog on interstate commerce. These units are very much concerned about the loss of revenue and the competitive imbalance for their home vendors, not only because of the new forms of commerce but also because of older mail order operations (which have enhanced their operations electronically)

In order to either meet the US Supreme Court test or to persuade the US Congress to pass an authorizing law, a number of states have supported the Streamlined Sales Tax Project. This is intended to develop, among other things, a common dictionary of terms and an easier method of determining and collecting tax. Approximately thirty-eight states are involved.

While progress has been made, there remain substantial obstacles to achieving a truly uniform system. It appears to be the hope that a sufficient degree of uniformity can be achieved to allow a technology solution to be implemented.

A small technology project has now been running for over a year.

The objective is to have a system in place by December 31, 2005.

Latin America

The tax environment in Latin America is not generally favourable for facilitating e-commerce.

Latin America is generally characterized by a fluid tax environment with less developed tax infrastructures. Only Mexico is a member of the OECD and generally, the tax treaty network is

limited. These countries rely substantially on withholding taxes to protect their fiscal territory. There are numerous sales taxes, both VAT and non-VAT, including a large number imposed at a sub-national level.

GBDe Comments on Developments in the Americas

Both Canada and the United States' subnational transaction/consumption tax systems illustrate the difficulties inherent in imposing cross-border tax collection obligations in the context of remote sales. The issues faced by these two countries highlight the importance of ensuring that any global consumption tax collection regime be able to address variations in the consumption or transaction tax systems of countries at both the federal level and subnational levels and the need for a technologically feasible, commercially viable tax collection regime.

The GBDe endorses an extension of the current U.S. moratorium on new and discriminatory taxes on the Internet. Such a moratorium is not intended to avoid tax responsibilities or the collection of consumption taxes legitimately owed, but would allow for a thoughtful and global response to Internet taxation and give states and localities time to dramatically simplify their sales tax systems. GBDe supports substantial simplification of state sales tax systems, as well as clear jurisdictional standards. GBDe also endorses efforts to eliminate taxes on Internet access.

Europe/Africa

According to the former intra-community VAT rules, businesses established within the EU had to charge VAT on downloadable products delivered to businesses or end-users, regardless of whether they are located inside or outside the EU. On the other hand, non-EU businesses did not have to charge VAT on downloadable products delivered to end-users established within the EU. This situation concerned European governments and businesses for two reasons: 1) the potential loss of revenue, which is now widely acknowledged to be quite small (regardless of the importance of the underlying turnovers for the respective company); and 2) the creation of a non-neutral environment. For example, a German provider would be obligated to charge consumption taxes on a sale of software downloaded to a German consumer. However, a United States vendor of a similar product would have no obligation to collect the VAT. Hence, there is a competitive distortion based on tax treatment.

On May 7, 2002, the European Council published a Directive regarding the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services¹⁹; in the same context and on the same day a Council Regulation for the administrative cooperation in the field of indirect taxation (VAT) as regards additional measures regarding electronic commerce was published²⁰.

The Directive consists of two basic parts:

- Place of Supply Rule for Electronically Supplied Services: In case of a service performed for a "non-taxable person" (i.e. basically business to consumer) by a "non-established taxable person" (i.e. basically suppliers from outside the European Community) the place of electronically supplied services shall be where the non-taxable person is established, has his permanent address or usually resides. According to an Annex electronically supplied services can be – inter alia – web-hosting, supply of software, information, music, films and games.
- Special Scheme for Non-Established Taxable Persons Supplying Electronic Services to Non-Taxable Persons.

The European Union, through its controversial proposed Amendment to the Sixth VAT Directive, is the first government to attempt to address this issue legislatively. The EU directive would require online sellers of digitized goods and services to register for VAT collection purposes in a single EU member country. The non-EU vendor would be obligated to collect and remit VAT to the country in which it registered for all sales to EU consumers.

GBDe Comments on Development in Europe/Africa

The GBDe appreciates and understands the EU's rationale for amending the Sixth VAT Directive in order to collect taxes that are legitimately owed. However, the Directive leaves some critical issues unresolved, including liability issues for companies making good faith efforts to collect taxes given the limited technological capabilities in existence today, the enforceability of an essentially voluntary system and the continued presence of competitive distortions for some stakeholders.

¹⁹ Council Directive 2002/38/EC of 7 May 2002, OJ L 128, p. 41.

²⁰ Council Regulation (EC) No 792/2002 of 7 May 2002, OJ L 128, p. 1.

In all regions, a number of firms are actually engaged in the production of digital products. Many of these firms are small and medium size enterprises (with less than 100K European sales) for whom compliance with the EU VAT directive will be particularly problem and costly.

The GBDe remains concerned that the proposed taxation of digital information is inconsistent with the principle of neutrality in that online and offline versions of similar products will be treated differently for tax purposes even though consumers would purchase the products for the same purpose. For this reason, the GBDe urges the EU to review the so-called Annex H of the Sixth VAT Directive, so as to ensure fair and non-discriminatory VAT treatment of goods and services ordered online whenever off-line substitutes are subject to a lower VAT rate for various policy reasons.

The GBDe urges the EU Commission and the Member State governments to address the real “doing business” issues to make complying with the EU VAT system easy, commercially viable and technologically feasible. Companies should only held liable under these preconditions.

As the issue of majority voting on taxation issues regrettably was left undecided by the Nice Treaty we also urge the Member States to tackle this issue at the forthcoming Intergovernmental Conference in 2004, with the objective of harmonizing VAT rates in Europe, or alternatively to use the procedures of enhanced cooperation to achieve this purpose within a first group of Member States. The GBDe also invites the EU to identify potential ways to eliminate or reduce any competitive distortions, such as applying a single rate for all digitized sales into the EU by all vendors. From a broader perspective, the GBDe supports the EU's goals of achieving simplification and easing the burden of compliance, but remains concerned that the current Directive will discourage tax authorities from efforts to develop a global solution to these issues, and will create an unfortunate precedent for other jurisdictions.

The GBDe recognizes that recent proposed amendments have been a first step in a long process, and that a great deal of continued dialogue will be necessary to adequately resolve the range of concerns. In this context, the GBDe would welcome the opportunity to enter into a direct dialogue with the EU and separately with any other governments around the world to discuss the kind of tax regime for e-commerce that would benefit all stakeholders.

ASIA/OCEANIA

The GBDe conducted a survey of VAT in each country of Asia/Oceania Region (see p. ...). It has turned out that compared with ones in the EU member states, the rate of VAT is relatively low in the Region except for China (17%) and New Zealand (12.5%). In some countries such as Malaysia and India, the VAT legislation itself has not yet been installed. Therefore, the issue of VAT to be levied on online digital product has been paid a very low attention in this region.

China

In China, VAT (Value Added Tax) is separated from Consumption Tax. Which of VAT and Consumption Tax will be levied is determined, depending on the nature of goods and transactions. However, it is very rare that both of VAT and Consumption Tax are levied at the same time.

China recently announced its intent to ensure its consumption tax system is applied to online sales. Regulations are currently being developed toward this end.

India

In India, at present in respect of e-commerce transactions, where transaction is concluded online and goods are delivered physically, in case of domestic sales, either central sales tax, state sales tax, as may be applicable, is levied, whereas, in case of international sales, custom duties shall be applied. The rate of duty applicable shall depend upon the commodity sold and the tax specified in respect of that commodity under the relevant act. In respect of sale of digital goods, where the goods are transferred online, at present there are no specific provisions in respect of taxation of such transactions.

- a) Sales tax: In India sales tax is levied by the respective states under the state sales tax laws, and also by the centre under the Central sales tax act. State levies sales tax on the sales taking place inside the state and the sales taking place in course of inter state trade & commerce are taxed by the centre under the central sales tax act.

Where sales take place in course of import/export, no tax is levied under the central/state sales tax act.

- b) Custom duties: are levied on imports into India at the rates specified in the custom tariff act in respect of the commodity imported.

- c) Concept of VAT: VAT is a form of sales tax only. This concept is in the process of being conceived and at the moment, and it is endeavor of government to switch over to VAT from April 2003 onwards.

Japan

The Government of Japan (GOJ) officially agreed to the recommendations of the OECD Working Party 9 on Consumption Taxes and OECD Consumption Tax Technical Advisory Group (TAG), namely, a simplified registration-based collection system for the business to consumer transactions. Japan, as one of the major consumption tax system countries, shares European concerns, which are the potential for (i) distortion of competition, and (ii) significant present or future revenue loss. However, even when the GOJ decides to implement national legislation to adopt the OECD-recommended simplified registration system, it will find it difficult given the conditions set out by the OECD for establishment of such a system. These conditions are (i) minimization of compliance burdens, (ii) application of registration thresholds, and (iii) control and enforcement measures to ensure compliance. Given the current situation where a simplified registration system will be hard to implement in practice, it would be worthwhile to undertake a study of technology-based options for medium-term tax collection systems, as the OECD recommended. Otherwise, other stakeholders in countries without consumption tax systems will press for a permanent standstill (i.e., no indirect taxation of digital goods on a cross-border business to consumer basis).

The Ministry of Economy, Trade and Industry of Japan (METI) recently submitted a proposal for such technology-based options to the OECD, in response to the OECD's request for public comments on the Working Party 9 and Consumption Tax TAG reports. The Japanese proposal focuses on reducing burdens for tax collection for business and consumers, and also aims at minimizing complex national sovereignty problems. In its proposed "Multinational Hybrid" concept, a vendor who transacts with a consumer submits a transaction report to a newly established "Global Vendor Registration Body" based on multinational agreements as an alternative to the usual national registration model.

The "Global Vendor Registration Body" then forwards the notices with the transaction report to both the taxation authorities of the countries of the vendor and consumer, and to the consumer in the consumption country. The Trusted Third Party

(TTP) in the consumption country collects the consumption tax from the consumer and remits it to the taxation authority in the consumption country. The taxation authority then matches the amount remitted with the transaction report received from the Global Vendor Registration Body. In this proposed system - in contrast to those called for under the EU Sixth VAT Directive or the simplified registration system as recommended by the OECD - the vendor does not necessarily have to register in each taxation authority in the more than 100 VAT countries (thereby reducing compliance burdens on business). Moreover, the vendor is not subject to the direct enforcement powers of the taxation authority of the consumption country, thereby minimizing sovereignty problems.

Korea

In Korea, the Ministry of Finance and Economy announced in 2001 that it would levy a 10% VAT on online digital product, but the discussion was shelved.

Philippines

In the Philippines, VAT on physical product has already been introduced. The Taxation Office has eagerly discussed the electronic commerce taxation legislation since last year so that VAT could be levied on online digital product as soon as possible. It is expected that VAT on online digital product will be introduced soon.

Taiwan

In Taiwan, no explicit legislation has yet been introduced for VAT to be levied on online digital product. However, on a customary basis, the domestic vendor of online digital product would collect 5% of VAT from the customer and pay to the taxation office. As for the cross border transaction of online digital product, the vendor is expected to report the case to the local taxation office and to follow their instructions.

GBDe Comments on Development in Asia/Oceania

The GBDe appreciates and understands the concerns of Asian countries with a VAT system (e.g. China, Japan) regarding the distortion of competition and possible revenue losses. The GBDe is committed to working with all governments in Asia (and around the world) to develop the tax regime that advances and promotes e-commerce while at the same time addressing governmental concerns.

Regarding Japan the GBDe seeks to continue work with the OECD in its examination of the mid-term technology-based options (including METI's proposal), in order to move beyond the current de-facto moratorium as soon as possible.

OECD

International consensus is critical to ensure that e-commerce taxation is neutral, enforceable and easily administered. If each of the 100+ VAT jurisdictions (e.g., Japan, Australia, Canada) impose different collection systems, businesses would face a high level of complexity and the potential for double or discriminatory taxation. This would discourage the kind of cross-border transactions that e-commerce enables which benefit both consumers and businesses alike.

To prevent this outcome, government and industry must continue to work toward long-term solutions for indirect taxes. For example, the OECD Technology TAG has identified four collection model options, including self-assessment, tax at source and transfer, registration of non-resident vendors, and the use of third party intermediaries. The TAG has recommended the tax-at-source option for business-to-consumer transactions combined with a trusted third party clearinghouse system. It observed that registration of nonresident vendors raises significant problems with regard to verifying the location of consumers. These recommendations require and merit further study by all stakeholders in industry and government.

The OECD Working Party 9 on Consumption Taxes and the OECD Consumption Tax TAG have issued similar reports calling for a clearer definition of taxation in the place of consumption, and recognizing the practical difficulties inherent in the application of traditional consumption tax principles to the delivery of services in electronic commerce, and in the registration and collection process. For business to business transactions, the reports support jurisdiction to tax based on the location of the recipient's location, with a reverse charge or self-assessment collection system. For business to consumer transactions, they recommend jurisdiction based on the recipient's usual residence, and a simplified registration-based collection system, but recognize the difficulties in identifying an online customer's jurisdiction. The reports suggest the interim use of technology-based collection mechanisms, such as trusted third parties or digital certificates, but recognize the lack of effective technological tools at this time.

The GBDe supports the conclusions of both reports that further efforts are required to define

the place of consumption, particularly regarding businesses with multiple locations and the definition of "usual place of residence" for consumers. We urge tax authorities to cooperate on such definitions and any anti-avoidance measures to limit the possibility of double taxation. We urge the adoption of safe harbor provisions that protect businesses from liability once they have taken reasonable steps to identify customers and jurisdiction. The GBDe cautions that international cooperation is needed to ensure that the obligations placed on multinational businesses are consistent with the principles and goals of other international organizations. We strongly believe that evolutionary changes in the tax system should not force businesses to make frequent and costly business changes or technological investments for tax reasons alone. Consequently, short-term solutions to difficult issues such as verification of residence must be balanced with the burdens and costs imposed by compliance methodologies. We urge a renewed focus on simplification as a vital means of achieving widespread compliance. Finally, the GBDe applauds the recommendation in both reports that the business community plays an active and important role in the ongoing work in developing consumption tax standards for the networked economy.

The GBDe urges the OECD to discuss bi- or multilateral treaties to avoid double taxation under VAT regimes. If a global legislation standard is not possible these treaties and a commentary with common interpretation could solve many problems caused by competing VAT legislation.

GLOBAL DIRECT TAXATION

Direct (e.g. income) tax rules governing traditional commerce typically required some degree of physical presence before taxation can occur. The Internet allows enterprises to conduct business in remote jurisdictions, causing authorities to re-examine these rules and their application in an online environment. Areas under scrutiny include permanent establishment, how to characterize income earned online, and transfer pricing.

Americas

Canada

Canadian authorities have accepted the recent work of the OECD in regard to eCommerce. However, as no treaty or legislation has been changed, it remains to be seen if the courts will accept these positions.

Canada has removed its observation to the Commentary on Article 12 of the OECD Model Tax Convention on Income and Capital (April 29, 2000 condensed version) concerning the taxation of royalties to bring Canada closer to the international standard in regard to withholding on computer software. It has also expanded the countries for which no withholding is required through treaty negotiation although the list remains short.

Canada has become increasingly vigorous on its requirement for withholding (on an installment rather than final tax basis) for services performed in Canada. It applies, subject to certain very limited administrative relief, even where no permanent establishment exists. The recent OECD positions may expand the impact of this requirement.

United States of America

International treaties do not bind United States sub-national units. They are generally suffering a revenue shortfall and have tried to extend their taxing jurisdiction over activities where the connection is relatively slight. While the results have been mixed, they have not been without success.

A new area of concern in the area of electronic business is the potential double taxation of telecommuting employees. New York in particular has been successful in taxing employees resident and operating outside the jurisdiction where their connection with the New York office is substantial.

Asia/Oceania

India

The Indian Income tax department has identified the electronic transactions carried on by MNC's, viz. credit card companies, and airline reservation companies (CRS) as a major source of revenue. In such transactions the CRS companies facilitate the global reservation of air tickets by the agents world over, for which they use a CRS HOST SYSTEM which is located in a country outside India, which may or may not be residence of the CRS company, and the information can be accessed to by the travel agents through a router located in the India. The tax authorities, have sought to tax the booking fee, which originated in India as incomes of CRS companies, and it has been justified on the ground that the presence of router of CRS Company in India, constitutes its PE (permanent establishment). This position adopted by the tax authorities can be countered on the ground that, mere presence of router

cannot constitute PE. As per the definition of the PE also, mere presence of equipment cannot constitute PE unless some business activity is carried through PE. Additionally routers do not form a significant part of equipment, used for conducting business, and the activity carried through routers is auxiliary in nature and may not constitute a PE. Therefore CRS companies have tightened their belts for a long legal battle, and some are also invoking the mutual agreement procedure under DTA,

A high powered committee has been set up by the Central Board of Direct Taxes to study and recommend the mythology for taxation of e-commerce transaction. Such a committee has submitted its report in September 2001, which is now under consideration.

OECD

Permanent Establishment

A company must have a minimum threshold of activity and presence to be liable for income taxes in a tax jurisdiction. In the international tax arena, this threshold is known as permanent establishment (PE) and is governed by international treaties and domestic law. PE typically includes a fixed place of business (e.g., factory, office, workshop) used by a foreign enterprise for more than some minimal period of time. However, an enterprise can also establish PE if it uses agents to conclude contracts on its behalf in a jurisdiction where it otherwise has no physical presence. For example, if a vendor hires a contractor to close sales in a foreign country, that vendor can have PE. Activities that are preparatory or auxiliary in nature to an enterprise's core function are generally excluded from any determination of PE.

Electronic commerce does not require fundamental changes to PE rules. Abandoning existing tax principles could lead to discriminatory tax treatment of Internet-related activities.

Interpreting PE rules is already a complex endeavor, even in traditional commerce (*i.e.*, the definition of a "fixed place of business" or "preparatory or auxiliary" activities). The ability of enterprises to reach new markets using the Internet, without the large-scale infrastructure investments common to traditional commerce, raises even more questions regarding PE rules.

The Committee on Fiscal Affairs of the OECD, on recommendation of Working Party 1, has adopted changes to the commentary language on Article 5 of the OECD Model Treaty regarding permanent establishment. The GBDe is encouraged by the

language indicating that Internet service providers do not constitute dependent agents or PEs for enterprises that carry on business through a hosted web site. The GBDe is also encouraged by the conclusion that the mere presence of a web site alone will not create PE for its owner. However, the GBDe is disappointed that the CFA has taken the aggressive and unprecedented position that the mere presence of “machinery or equipment”, such as a server, may constitute a PE when it performs an essential or core part of the taxpayer’s business activity, terms which remain undefined. This controversial proposal deserves further examination with input from the business community and the Business Profits TAG.

Moreover, this conclusion that a server can constitute a PE is a threshold to further complex issues for the Working Party as to how income is to be allocated to a server which has been determined to be a PE. In conjunction with its work on permanent establishment, the Business Profits TAG has issued a discussion draft noting that the CFA is considering changes to the Model Treaty commentary urging the application of the arm’s-length principle in a manner that reflects economic reality, although it notes the lack of consensus as to how much and which profits can be attributed to a PE, and the many difficult practical questions yet to be addressed in applying the arm’s-length principle.

The GBDe notes with interest and concern the adoption by the Committee on Fiscal Affairs of the OECD of recommendations by Working Party 1 to supplement the commentary on article 5 of the OECD Model for Tax Conventions relating to the definition of permanent establishment in the context of electronic commerce. Their conclusions raise several issues that may have dramatic consequences for businesses.

As in the transfer pricing area, the GBDe believes that the governing principle should continue to be the elimination of double taxation in a manner which minimizes compliance burdens. The GBDe urges the Business Profits TAG to work closely with the business community as it considers these difficult issues.

Characterization of Income

Many types of products can be digitized and transferred electronically, including computer programs, books, music and other types of images (e.g., motion pictures, videotapes, etc.). These types of transactions have occurred for many years in more traditional formats and going forward will increasingly continue to occur in electronic and non-electronic form. Accordingly,

any changes to be effected in the tax rules involving these data transfers must accord neutrality of treatment to non-electronic transactions as well as to their electronic counterparts.

Rules governing income characterization should treat similar products and services neutrally. The GBDe does not believe that new rules to govern the classification of income are necessary. Instead, a facts and circumstances approach would ensure equal treatment of business activities, and would decrease the likelihood of double taxation of e-commerce generated income. The GBDe endorses the clarification work of the OECD Income Characterization TAG as it identified the range of e-commerce transactions and worked to reach consensus on how each should be classified for income tax purposes.

The GBDe remains concerned, however, with unilateral efforts to sweep the full range of digital products into one particular category, as doing so can lead to non-neutral tax treatment of these products. The GBDe prefers the facts and circumstances approach being utilized by the Income Characterization TAG as a more thoughtful means to classifying Internet-related activities, and cautions that uniform characterization principles are essential to avoid double taxation.

Transfer Pricing

The Business Profits TAG has reported that it will continue its ongoing work regarding transfer pricing issues relating to the allocation of income between affiliated companies engaged in electronic commerce. The TAG has yet to publish proposals in this area, which in any event we presume will be substantially shaped by the existing OECD guidelines and the ongoing efforts of Working Party 6. The TAG has stated that its work will be informed by feedback from the business community as to the priority issues.

The GBDe believes that the existing arms-length principles continue to be relevant in the networked economy, that the focus should continue to be the elimination of double taxation, and that efficient dispute resolution and compliance burdens continue to be key issues in the transfer pricing area.

GLOBAL TAXPAYER SERVICE

Several governments and government organizations are attempting to make use of available technology in the administration of their

tax systems in order to improve taxpayer services and collections. The OECD's Forum on Strategic Management has issued a report: "Tax Administration Aspects of Electronic Commerce, Responding to the Challenges and Opportunities" in February 2001, which deals with:

- taxpayer service,
- tax administration, identification & information needs; and
- tax collection and control; as elements of tax administration.

As implementation options with respect to taxpayer services, the FSM identifies:

- developing Internet web sites where information, such as tax legislation, rulings, case law, revenue statistics and forms can be viewed and down loaded.
- interactive telephone answering systems for many standard inquiries.
- a single e-mail access point for highly mobile taxpayers.
- receiving and responding to taxpayers' service enquiries by e-mail.
- direct deposit programs for tax payments and refunds.
- accepting tax return data and other information by use of the new technologies.
- automated payments of social security, payroll taxes and other similar deductions.

Similar approaches are being discussed globally by national tax authorities.

The GBDe supports current work on taxpayer service models as an important complement to existing discussions on national income and consumption tax regimes. The GBDe urges government to prepare a roadmap from which unilateral national taxpayer services can be multilateralized on the basis of globally agreed standards. The GBDe is prepared to start work on these models with governments and government organizations and to contribute to the technical possibilities for making such taxpayer services systems a reality.

CONCLUSIONS

The GBDe encourages governments to work with industry to craft a long-term tax system that eliminates competitive distortions and adheres to the principles of simplicity, neutrality and global viability. We strongly recommend extensive government-to-government discussions, which will minimize the likelihood of potentially conflicting national approaches. By fostering the continued growth of our networked economy,

such international dialogue will benefit governments, merchants and consumers alike.