Notes

Taxation of Global E-Commerce on the Internet: The Underlying Issues and Proposed Plans

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PROLOGUE

The number of transactions conducted over the Internet has expanded exponentially in the past few years, and countries have become cognizant of the potentially large consequences that “electronic commerce” may have on their important tax revenue bases. As a result, numerous international organizational conferences and intergovernmental meetings have occurred in the past two years dealing with the topic of electronic commerce taxation. Three notable proposals for electronic commerce taxation have emerged from these meetings: the Clinton Administration’s “e-card” proposal, the European Community’s “VAT” proposal, and the so-called “bit” tax.

This Note examines these three proposals, and argues that the Clinton Administration’s e-card proposal should be adopted—with some modifications and additions. Part One of this Note presents an introduction to the rise of electronic commerce, looks at some basic taxation principles, and also gives a broad overview of the three main electronic commerce tax proposals. Part Two of this Note analyzes the advantages and disadvantages of the three proposed electronic commerce taxing schemes. Finally, Part Three presents a proposal for taxing electronic commerce, utilizing the Clinton Administration’s e-card scheme as a template for further discussion.
PART ONE: THE TAXMAN COMETH

I. THE RAPID ASCENDANCE OF GLOBAL ELECTRONIC COMMERCE

A. THE CREATION OF “CYBERSPACE”

Over the past decade, the world’s fastest growing commercial center has not been in any specific geographic location. Rather, this growth has occurred in the amorphous, nebulous region of computer communications topography known as Cyberspace—also commonly referred to as the “Internet,” or the “information superhighway.” Created in 1969 by the United States Department of Defense Advanced Research Projects Agency, the original Internet was quickly adapted for academic use in the 1980s. In the mid-1990s, the creation of the “World Wide Web” (“Web”) and improvements in telecommunications technology spurred commercial application of Internet technology. Such technologies have enabled the Internet to handle virtually any form of digital information—including text, sound, graphics and video. As a result, businesses can now use the Internet to reach millions of people around the world, and the pace of commerce conducted electronically has grown dramatically.

According to the Organization for Economic Co-operation and Development (OECD), the level of electronic commerce (hereinafter, “e-commerce”) is expected to grow from a current $US 26 billion a year to a staggering $US 1 trillion within the next seven years. In the United

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2 See Cigler, supra note 1, at 340. See also Ian C. Ballon, Linking, Framing and Other Hot Topics in Internet Law and Litigation, 520 PLI/Pat 167, 175 (1998) (indicating the term “cyberspace” was coined by author William Gibson in early 1980s; Gibson foretold a world of “virtual reality,” generated by computers in which people could interact, conduct business, and entertain themselves); David S. Prebut, State and Local Taxation of Electronic Commerce: The Forging of Cyberspace Tax Policy, 24 Rutgers Computer & Tech. L.J. 345, 346 (1998) (stating the Internet is shorthand for “interconnected networks,” an international aggregation of computers and communication networks).

3 See Prebut, supra note 2, at 346 (noting that the term “Internet” is shorthand for “interconnected networks,” an international aggregation of computers and communication networks).


5 See Prebut, supra note 2, at 347.

6 See id. at 348-49.

7 See id. See also Neal Friedman, The Legal Challenge of the Global Information Infrastructure, 2 No. 10 Cyberspace Law 8 (1998) (providing a general history of the Internet).


9 See Cigler, supra note 1, at 340.

10 See id. See also Mai-Tram B. Dinh, The U.S. Encryption Export Policy: Taking the Byte out of the Debate, 7 Minn J. Global Trade 375, 377 (1998) (explaining how the Internet is creating great opportunities for small and large businesses around the globe).


States alone, electronic commerce sales are estimated to reach $US 300 billion by the year 2002. The projected explosive growth of e-commerce has prompted President Clinton to deem the Internet the “Wild West” of the global economy. Similarly, financial commentators have likened current e-commerce participation to a “modern day gold rush . . . as businesses rush to seek their fortunes with the software equivalents of shovels, picks, and pans.”

One of the main reasons for e-commerce’s booming popularity has been its potential beneficial effects on business’ bottom lines. By conducting transactions over the Internet, businesses have the potential to significantly improve market efficiencies by eliminating middlepersons, and allowing for better management of supplies, production, and distribution. Consequently, the OECD states, “it is clear that accepted ways of doing business will be profoundly modified: traditional intermediaries will be replaced, new products and markets will be created, new and more direct relationships will be forged between businesses and customers.”

B. DEFINING “E-COMMERCE” MORE PRECISELY

The United Nations Commission on International Trade Law (UNCITRAL) has defined electronic commerce as “commercial activities conducted through an exchange of information generated, stored, or communicated by electronic, optical, or analogous means.” More specifically, electronic commerce has become an umbrella term for telecommunications activities conducted over open computer networks, such as the Internet. Such activities may include electronic data interchange (EDI), on line retailing, and electronic financial services (such as home banking, electronic funds transfer (EFT), payment processing, and business process reengineering). To date, the World Trade Organization (WTO) has not promulgated a

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14 See *Information Technology: Administration to Negotiate in WTO for Internet Trade Free of Barriers*, 14 Int’l Trade Rep. (BNA) No. 28, at 1178 (July 9, 1997).
17 See id.
18 OECD, *Dismantling the Barriers to Global Electronic Commerce, Background Paper for Turku Conference*, 1 (October, 1997). In addition to affecting commercial life in profound ways, the OECD also see electronic commerce as having “potentially far-reaching economic and social implications for many facets of life, including, the nature of work, the role of governments, and even the environment.” Id.
20 See OECD, *OECD Policy Brief No. 1-1997* (from <http://www.oecd.org/publications/Pol_brief/9701_pol.htm>). The OECD has defined the term, “electronic commerce,” as referring generally to “commercial transactions, involving both organizations and individuals, that are based upon the processing and transmission of digitized data, including text, sound and visual images and that are carried out over open networks (like the Internet) or closed networks (like AOL or Minitel) that have a gateway onto an open network.” Id.
21 See Craig W. Harding, *Selected Issues in Electronic Commerce: New Technologies and Legal Paradigms*, 491 PLI/Pat 7, 10 Sept., 1997. See also Kyrie E. Thorpe, *International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?*, 11 Emory Int’l Law Rev. 633, 647-649 (1997) (stating that the most prevalent classes of sales and transactions which take place on the Internet are: retailing and wholesaling, computer software, photographs, online information, services, health care, electronic
formal definition of the term “electronic commerce,” but trade diplomats say the term is understood to generally mean transmissions involving electronic information sent over the Internet or other means of telecommunications. Some examples of products currently being sold over the Internet include:

1. **The retailing and wholesaling of physical goods**: retailers and wholesalers may use the Internet to supplement or replace paper catalogs and advertisements. This category of electronic commerce is most akin to traditional business methods.

2. **Computer software and online database information**: Customers may access web sites to purchase downloadable software or access electronic research databases.

3. **Digitized information**: customers may access web sites and rent or purchase images in digital form that are transmitted over the Internet.

4. **Financial services**: clients may use the Internet to trade stocks and purchase securities or to access a “cyberbank” and do remote on-line banking.

Currently, the business to business segment of e-commerce activity accounts for eighty percent of all e-commerce, and it is likely to spur the most Internet sales growth in the next five to ten years. Significantly, it is American companies that dominate the e-commerce landscape—with an estimated eighty percent of all global e-commerce sales coming from the United States. Many people with knowledge of the Internet feel that the most innovative, paradigm-shifting Web sites are American. As a result of their dominance, American companies are increasingly looking to expand their e-commerce presence globally, where the American firms can use their economies of scale to capture a new class of customers.

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23 See Thorpe, supra note 21, at 647.
24 See id. at 648.
25 See id.
26 See id. at 649.
28 See Kimberly Strassel, Internet’s Relative Economic Impact is Played Down in Report by OECD, Wall St. J. Europe, Sept. 28, 1998, at B9H.
29 See id.
30 See Lavin, supra note 16 (giving examples of revolutionary American Web sites which include the online bookstore, Amazon.com, and auto sales and electronic brokerage sites).
31 See W. Scott Blackmer, Going Global with Electronic Commerce, 1 Elec. Banking L. & Com Rep. 1 (1997). See also Department of the Treasury, Selected Tax Policy Implications of Global Electronic Commerce (1996) at 8 (“[T]he growth of electronic commerce will be driven in part by the fact that the present [U.S.] economy’s important products are software and recorded entertainment (both films and music) which are particularly well suited to being distributed through computer networks.”).
The global and amorphous nature of cyberspace puts regulation of the Internet out of the purview of any single government. However, because electronic commerce transactions are more likely to cross international borders than non-e-commerce transactions, e-commerce activities may be subject to a morass of conflicting national and local laws and regulations. The current regulatory environment inhibits the ability of the Internet to move e-commerce transactions around the globe in the most efficient and optimal manner. As long as the current regulatory environment for e-commerce exists, many companies will be unwilling to expand their presence on the Internet, for fear of uncertain and unpredictable costs. Specifically, two thorny problems plague the current e-commerce regulatory regime: vagueness and complexity. Since e-commerce is a new mode of conducting business transactions, laws governing e-commerce activity are themselves new or nonexistent. As a result, jurisprudential interpretation is nascent and undeveloped—and vagueness rules. Further complicating the matter are multiple laws which may be conflicting or irreconcilable. Such vagueness and complexity leads to undesirable economic costs for companies doing business on the Internet. For example, when laws are vague and complex, the need for lawyers increases, along with concomitant increased legal expenses.

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32 See Friedman, supra note 7.
33 See Blackmer, supra note 31.
34 See id.
35 See Friedman, supra note 7.
36 See id.
37 See Steven R. Salbu, Who Should Govern the Internet?: Monitoring and Supporting a New Frontier, 11 Harv. J.L. & Tech. 429, 461 (1998). Salbu concludes that a “truly global,” unified regulatory approach is best suited to solve the ever-expanding nature of the Internet. See id. at 452. See also Michael A. Geist, The Reality of Bytes: Regulating Economic Activity in the Age of the Internet, 73 Wash. L. Rev. 521, 554-55 (1998). Interestingly, Geist reverses the issue by asking how an increased reliance on the Internet for conducting business activity will impact economic regulation itself. Geist sees the Internet affecting economic regulation in four major areas: the Internet as “medium,” the Internet as “catalyst,” the Internet as “change,” and the Internet as “administration.” Geist concludes that the Internet will have profound effects on economic regulation, and, because of the Internet’s wide-reaching effect on economic activity, no single regulatory solution will suffice. See id. But see Scott F. Bain, Examining Traditional Legal Paradigms in a Non-physical Environment: Need We Invent New Rules for the Road for the Information Superhighway?, 12 Berkeley Tech L.J. 231, 233-4 (1997) (citing Professor Henry H. Peritt, who contends that existing legal principles can be adapted to the regulation of new technologies, such as the Internet. What is needed, says Peritt, is an understanding of the core legal principles posed by the new technology, and a corresponding adaptation of existing legal principles); Jane Kaufmann Winn, Open Systems, Free Markets, and Regulation of Internet Commerce, 72 Tul. L. Rev. 1177 (1998) (arguing that a skeptical attitude should inform the decision of whether to implement Internet-specific regulation, particularly laws designed to regulate Internet “public key cryptography,” technology which authenticates online “signatures.” Winn fears that Internet technology manufacturers will receive preferential treatment with respect to the implementation of new regulations—at the expense of consumers).
38 See Salbu, supra note 37, at 461.
39 See id.
40 See id.
41 See id.
42 See id.
Governments and other agencies have begun to recognize the growing urgency of these problems, and have produced a number of studies over the course of the past year, the most significant of these are discussed below. In this vein, the OECD has posited that:

The emergence of electronic commerce heralds a major structural change in the economies of the OECD member countries. It will affect the economic environment, the organisation of firms, the behaviour of consumers, the workings of government and most spheres of activity of households and citizens . . . [s]overeign nations will need to come to terms with the global and transfrontier nature of new networks and communications systems and establish a coherent, predictable, legal and regulatory framework in which global electronic commerce can flourish . . .

Following are brief synopses of recent responses from key global players in the area of electronic commerce regulation: the United States, the European Union, the OECD, and the WTO. Generally, these responses state two common themes: (1) the need for a recognizable general governmental policy on e-commerce, and (2) the importance of the development of specific e-commerce tax policies. It is also interesting to note how the responses differ—the United States is generally more concerned with companies’ unfettered access to free market flows on the Internet, while the E.U. is highly sensitized to the issue of data privacy, especially in regards to e-commerce consumers.

1. The US response:

In July, 1997, the Clinton Administration issued an interagency report entitled, “A Framework for Global Electronic Commerce.” The report cites the increasing economic importance of e-commerce, and states that the Administration’s main task with respect to the promotion of e-commerce is to help create an environment that “facilitates the emergence of a transparent and predictable legal environment to support global business and commerce.” With this objective in mind, the Framework establishes five broad guidelines for the encouragement of e-commerce: (1) e-commerce is best served by industry self-regulation and a minimum of government regulation, (2) governments should avoid imposing undue restrictions on e-commerce, (3) governments should support and enforce a simple, predictable, and consistent legal environment for e-commerce, (4) regulators should recognize the uniquely decentralized and bottom-up leadership characteristics of the Internet, and (5) regulators should adopt the principle of facilitating global commerce. Additionally, in recognizing the significance of taxation in the development of an overall e-commerce policy, the Framework states that there

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45 See id. at 1. The Framework states that, “Internet technology is having a profound effect on the global trade in services . . . [world trade involving e-commerce] has grown rapidly in the past decade, now accounting for well over $40 billion of U.S. exports alone.” Id.
46 Id. See also The White House Office of the Press Secretary, Presidential Message, July 1, 1997. President Clinton contends that government officials should adopt a “market-oriented” approach to the regulation of electronic commerce, in order that e-commerce can “grow and flourish.” See id.
47 See The Clinton Administration, supra note 44.
should be no undue tax burdens on Internet commerce, and also calls for no new taxes on e-commerce.\textsuperscript{48}

Prior to the Clinton Administration’s Framework, the U.S. Treasury Department released a study on e-commerce taxation\textsuperscript{49} which observed that:

[N]ew technologies, particularly communications technologies including the Internet, have effectively eliminated national borders on the information highway. As a result, cross-border transactions may run the risk that countries will claim inconsistent taxing jurisdictions, and that taxpayers will be subject to quixotic taxation.\textsuperscript{50}

In addition to the tax jurisdiction problem, the Treasury Department cites “tax neutrality,” “classification of income,” and “tax administration and compliance” as significant “transnational” tax issues deserving prompt attention.\textsuperscript{51} These issues are further discussed later in this note.

Thus, the United States’ overall objective, vis a vis e-commerce, is the expansion of e-commerce activity. Consequently, the United States desires open e-commerce markets—with minimal governmental regulations and minimized tax burdens.

2. The European Union’s response:

The European Commission’s “Initiative In Electronic Commerce” was released in the spring of 1997\textsuperscript{52} amidst concerns that the “rapid implementation” of e-commerce poses an “enormous challenge for commerce, industry and governments in Europe.”\textsuperscript{53} One of these challenges, the Initiative states, is that “Europe’s main competitors have already resolutely seized opportunities offered by electronic commerce—with the US building a substantial lead.”\textsuperscript{54}

\textsuperscript{48}See id. at 3-4. Aside from stating that no new taxes should be imposed on Internet commerce, the Framework also argues that any taxation of e-commerce should follow these general principles: any e-commerce taxes should not discriminate among types of commerce; tax systems should be simple and transparent; and the system should accommodate existing national taxing schemes. Id. at 4. Further exposition of the tax concepts underlying these principles follows below.


\textsuperscript{50}See Department of the Treasury, supra note 49, at 3.

\textsuperscript{51}See id. at 3-4. In light of the increasing importance of e-commerce, the Treasury Department also boldly calls for a reexamination of the Internal Revenue Code and “generally accepted principles of international tax policy.” See id. at 10.


\textsuperscript{53}European Commission, supra note 52.

\textsuperscript{54}Id.
The Initiative pronounces that the EC’s first objective with respect to e-commerce is to provide a regulatory environment that can “build trust and confidence”—primarily by addressing the issue of data privacy for consumers and businesses. The report states that e-commerce cannot develop unless consumers and businesses are confident that their transactions will not be intercepted or modified, and that the transactions are “available, legal and secure.”

The E.U. Initiative also calls for: (1) consistent and workable regulations in the areas of contracts and e-payments, (2) progress towards a global regulatory framework, and (3) the assurance of a “clear and neutral” tax environment. Specifically, the Initiative advocates an e-commerce tax system that provides for “legal certainty” and “tax neutrality.” While the E.U. and the United States share similar ideas regarding e-commerce regulation, the E.U. appears less concerned about a minimal regulation (e.g., low tax burden), open market e-commerce environment than does the United States. Though the E.U. is cognizant of the American lead in e-commerce activity, the E.U.’s desire to catch up to the U.S. appears tempered by a strong emphasis on data privacy.

3. The WTO’s response:

The WTO has been very active in studying the issue of e-commerce regulation, and plans to play a central role in global e-commerce regulation. A March, 1998 WTO report cited the following as key issues deserving “further consideration”: (1) the establishment of global telecommunications infrastructure standards, (2) a predictable legal and regulatory structure for enforcing legal rights, (3) content regulation laws, and (4) a predictable framework for taxation and financial regulation. The WTO acknowledges that because taxation of e-commerce will be

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55 See id. See also Mark E. Budnitz, Privacy Protection for Consumer Transactions in Electronic Commerce: Why Self-Regulation is Inadequate, 49 S.C. L. Rev. 847 (1998) (providing reasons why consumers are wary of conducting transactions on the Internet).
56 European Commission, supra note 52.
57 See id.
58 See id. at 13-14.
59 See id.
60 See id.
62 See Winston J. Maxwell and Thomas P. Newman, Electronic Commerce Considered By World Trade Organization: Comprehensive Regulatory Review Begun, N.Y. L.J., November 16, 1998 at S7. Because of the multidimensional nature of e-commerce, the WTO expects to play a central role in its regulation and become the “pre-eminent body” in the international regulation of e-commerce. Furthermore, the WTO expects a “wide scope of competence” for its role in regulating e-commerce, expecting e-commerce issues to touch not only upon traditional GATT (General Agreement on Tariffs and Trade) and GATS (General Agreement on Trade in Services) areas, but also multilateral agreements—especially those touching upon intellectual property, telecommunications, and government procurement. Id.
63 See 15 Int’l Trade Rep. (BNA) No. 29, supra note 61, at 1307.
one of the most delicate areas for negotiations (because of multi-jurisdiction and other issues),\textsuperscript{64} further research needs to be conducted in the areas of double taxation, tax jurisdiction, and currently proposed taxing schemes such as the “bit tax” and “VAT tax.”\textsuperscript{65} In keeping with its role as overseer and arbiter of international trade, the WTO is particularly concerned with e-commerce’s impact on developing countries.\textsuperscript{66} With the other e-commerce issues, however, the WTO appears currently to be taking a detached posture, only suggesting areas of concern for further consideration and study, waiting for member countries to develop their own policy responses before taking any firm positions of its own.\textsuperscript{67}

4. The OECD’s response:

The OECD released a background paper in October, 1997, suggesting a set of key areas for governments to ponder in the development of national policies on e-commerce.\textsuperscript{68} Among

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\begin{enumerate}
\item See id.
\item See id. Developing countries fear that their overall bargaining power with respect to trade may diminish, as developed countries further develop their e-commerce capabilities—thus leading to an even greater disparity between the haves and have-nots. Id. Developing countries also worry that e-commerce will cause them to be more consumers rather than producers, further exacerbating current balance of payment problems with their wealthier counterparts. Id. From a taxation standpoint, then, developing countries would rather see an e-commerce taxing regime that favors the collection of taxes from the consumer rather than seller. Developing countries would consequently see less erosion of their tax bases under such a tax regime. See also John K. Sweet, Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles, 146 U. Pa. L. Rev. 1949, 1996-97 (1998) (examining the possible unfairness to developing countries of implementing the U.S. Treasury Department’s e-commerce tax proposals, because of the income loss to those countries if the Treasury Department’s plan is implemented). Sweet recommends the use of multilateral tax treaties as a partial remedy—the development of a “tax treaty network.” Id. at 2003-06. Such a network would provide greater information to both developed and developing countries as to the global flow of e-commerce tax monies, and treaties could provide an opportunity for redress of the erosion of developing countries’ tax bases. Id. See generally Department of the Treasury, Selected Tax Implications of Global Electronic Commerce, 18, (1996) (“[The] United States currently has comprehensive income tax treaties with 48 countries. The rules embodied in these tax treaties generally give the residence country an unlimited right to tax income while limiting or eliminating the source country’s right to tax.”); David R. Tillinghast, Tax Treaty Issues, 50 U. Miami L. Rev. 455, 455-56 (1996) (claiming that the United States’ income tax treaties with other nations are “endangered,” because of new economic developments that are shifting the economy away from the traditional industrial economy, and blurring previously discrete tax categories). But see OECD, Electronic Commerce: A Discussion Paper on Taxation Issues (1998). The Committee on Fiscal Affairs of the OECD feels, contrary to some commentators, that, “the principles which underlie the international norms that it has developed in the area of tax treaties...are capable of being applied to electronic commerce...” Id. at 22; Charles M. McLure, Jr., U.S. Tax Laws and Capital Flight from Latin America, 20 U. Miami Inter-Am. L. Rev. 321, 321, 356 (1989) (McLure, a Senior Fellow at Stanford University’s Hoover Institution, feels that the failure of developing countries—such as those in Latin America—to tax foreign source income has been a direct loss of revenue and capital that could have otherwise been used for “productive investment” at home, and that, consequently, developing countries can reverse this “flight of capital” only by insisting “en masse” that current global tax policies are unsatisfactory).
\item See WTO, supra note 61, at 1.
\item See OECD, Dismantling the Barriers to Global Electronic Commerce, Background Paper for Turku Conference (October, 1997). See also Electronic Commerce: OECD Releases E-commerce Blueprint; Will Hold Crypto Talks with Non-members, Int’l Trade Daily (BNA) (May 30, 1997), available in Westlaw, BNA-BTD Database. In this earlier “blueprint,” the OECD suggests that governments take action on three broad fronts: (1) supporting opportunities for the growth of e-commerce, (2) raising the visibility of e-commerce, and (3) defining new principles for the governance of economic activity in cyberspace.
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other issues addressed in the study, the OECD sees the need for governments to address the following: (1) easing barriers to electronic commerce to achieve a balance between self-regulation and a legal framework, ⁶⁹ (2) building user and consumer trust—with e-commerce regulations that boost confidence by providing greater user security and data privacy, ⁷⁰ (3) providing for consumer protection—especially with respect to fraudulent advertising or other illicit business practices by e-commerce merchants, ⁷¹ (4) minimizing regulatory uncertainty by a harmonization of national e-commerce policies, ⁷² (5) resolving intellectual property issues, ⁷³ and (6) the need for the resolution of multiple e-commerce taxation issues. ⁷⁴ The OECD has also stressed the requirement for a consistent national approach to developing e-commerce regulations, ⁷⁵ and sees both the public and private sectors playing an important role in the development of new e-commerce regulations. ⁷⁶

In regards to taxation, the OECD has stated that it sees “neutrality” as being the “guiding principle for the taxation of electronic commerce.” ⁷⁷ However, the OECD has also stated that it views taxation, of all the barriers, as being perhaps the most difficult to overcome in terms of expanding e-commerce, ⁷⁸ in part due to the multi-jurisdictional aspects of taxation. ⁷⁹

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⁶⁹ See OECD, supra note 68, at 3. The OECD suggests that any new regulation must allow consumers to have sufficient access to and use of e-commerce infrastructure (e.g., computers, servers, software, as well as the communications modes themselves (e.g., cable TV, cellular mobile networks, broadcasting networks)), and that also encourages economic competition among e-commerce companies. Id. at 3-6.

⁷⁰ See id. at 6-11. The OECD cites the “digital nature of electronic commerce” as allowing for the potential for “extensive international damage in a short time.” Id. at 8. Thus, the OECD recommends further investigation into the need for regulations requiring the use of cryptography, certification, encryption and other security-enhancing and data verifying technologies, in order to build greater business and consumer trust in electronic transactions. Id. at 6-11. Examples given of the possible “damage” that can befall e-commerce users are the potential for the pilfering of electronic signatures, as well as the illicit “mining” and use of private personal data. Id.

⁷¹ See id. at 12-14. The OECD sees the international and multi-jurisdictional nature of the Internet as a potential source for abuse of consumers by e-commerce vendors. Id. The OECD suggests that financial intermediaries and new technologies have a vital role to play in solving the issue. Id.

⁷² See id. at 15.

⁷³ See id. at 18. The OECD states that the resolution of intellectual property issues are crucial to the development of e-commerce. Id. (For instance, should e-commerce transactions be governed by existing WIPO and WTO TRIPS agreements?). Id.

⁷⁴ See id. at 15. The OECD sees source, residency, permanent establishment (concepts that affect tax jurisdiction), and characterization of income as being primary e-commerce tax issues that need to be solved. Id.


⁷⁶ See Electronic Commerce: Cooperation Accepted as Best Way Forward; OECD to Draw up Tax, Protection Guidelines, Int’l Trade Daily (BNA) (Nov. 24, 1997), available in Westlaw, BNA-BTD Database.


⁷⁹ See OECD, supra note 68, at 15.
II. GENERAL TAX PRINCIPLES RELEVANT TO E-COMMERCE TAXATION

A. THE PRINCIPLE OF “TAX NEUTRALITY”

The principle of tax neutrality requires that any equitable tax system treat economically similar income equally.\(^{80}\) For electronic commerce to flourish, the principle of tax neutrality, as applied to e-commerce, would require that income earned through electronic means should be taxed similarly to income earned through more conventional channels of commerce.\(^{81}\) To do otherwise would be to place e-commerce at a competitive disadvantage relative to other modes of commerce, defeating one of the purposes of an equitable tax system.\(^{82}\) The practical application of tax neutrality, then, would be a position that no “new” taxes should be placed on e-commerce transactions.\(^{83}\)

B. THE “PERMANENT ESTABLISHMENT” CONCEPT

Article 5 of the OECD of the Model Income Tax Convention, defines a permanent establishment as “. . . a fixed business place of business through which the business of an enterprise is wholly or partly carried on.”\(^{84}\) Article 5 also provides that a permanent establishment may be created in a country by means of an agent, broker, or general commission agent.\(^{85}\) Permanent establishment is a key tax concept because, under most tax treaties, a business must be determined to have a permanent establishment presence in that country before the country can attempt to tax the profits of the business.\(^{86}\) As the OECD has stated, “tax


\(^{81}\) See Sandi Owen, State Sales & Use Tax on Internet Transactions, 51 Fed. Comm. L.J. 245, 258 (1998) (“U]nder the principle of tax neutrality, goods and services provided in electronic commerce should be taxed no differently from goods and services provided in conventional commerce.”).  See also John Kennedy, Taxing the Net: The European Union is Keen to Implement a Framework for Applying VAT on Internet Transactions, Business and Finance, October 22, 1998; The Harvard Legislative Research Bureau, Remote Purchasing and Fundamental Fairness: The Sales and Use Tax Equalization Act, 35 Harvard J. Legis. 537, 537-39 (1998) (“[T]he principle of neutrality . . . requires that tax considerations not affect consumer choices.”).  The Harvard Legislative Bureau examines the issue of tax neutrality, vis a vis e-commerce, from a different perspective, and argues that equity requires that consumers not have an incentive to purchase from the Internet simply because of the ability to save taxes. Id. at 539.

\(^{82}\) See id.

\(^{83}\) See id.  See also the Clinton Administration, A Global Framework for Electronic Commerce (1998).  The Clinton Administration argues that no new taxes should be created to specifically tax e-commerce, since existing tax regimes should accommodate this new mode of economic activity. Id. at 4.  The OECD also agrees that no new taxes should be created for e-commerce transactions.  See OECD, Electronic Commerce: A Discussion Paper on Taxation Issues (1998).  The OECD states that different treatment for e-commerce transactions would be misguided, since e-commerce is not a new type of business or product, it is simply a “new mode of production, marketing, distribution, payment, etc.” Id. at 25.

\(^{84}\) See The 1992 OECD Model Income Tax Convention on Income and Capital, Article 5.  See also Cigler, Burritt, and Stennett, supra note 1.

\(^{85}\) See id.

\(^{86}\) See id.  See also Department of Treasury, Selected Tax Policy Implications of Global Electronic Commerce, 20 (1996) (“[I]t has come to be accepted in international fiscal matters that until an enterprise of one State sets up a permanent establishment in another State it should not properly be regarded as participating in the economic life of that other State to such an extent that it comes within the jurisdiction of that other State’s taxing rights.”).
Conventions generally provide that business profits of non-residents may only be taxed in a country to the extent that they are attributable to a permanent establishment that the enterprise has in that country.°

C. “SOURCE” AND “RESIDENCE” BASED TAXATION PRINCIPLES

Countries impose taxes on companies based on both the source and residence principles. In general, if it is established that a company is a “resident” of a country, that country may fix a legal right to tax that company’s income. The concept of residency is grounded in the permanent establishment principle, and residency requirements are usually tied to some geographic or physical presence in the country.

If a company fails to establish a residency in a country, the country may still impose taxes on the company’s income if it is determined that the “source” of the company’s income was derived from within the country’s borders. Most countries provide that the source of a company’s income is the country in which the economic activities generating the income occur.

Source of income principles generally have priority over residency rules, and the country of origin usually has the right to tax income. Double taxation is avoided by a credit or exemption system provided by the residence country. Such rules have been adopted by most taxing authorities worldwide.

° See OECD, Electronic Commerce: A Discussion Paper on Taxation Issues (1998). The OECD raises the issue of whether a website or other e-commerce presence in a country may qualify as a “permanent establishment.” Id. at 24. The OECD also acknowledges, however, that the concept of permanent establishment may be “ill-adapted” to e-commerce. Id. The consequences are profound, for the taxation of e-commerce may mean that many bilateral and multilateral tax treaties may have to be amended or scrapped in order to accommodate international e-commerce taxation regimes (since most tax treaties require some sort of permanent establishment presence before a country may tax a business).

88 See Cigler and Stinnett, supra note 80, at 59.
90 See Thorpe, supra note 23, at 655.
91 See Benjamin and Nathanson, supra note 89, at 30.
92 See id.
93 See The Department of Treasury, Selected Tax Policy Implications of Global Electronic Commerce, 18, (1996). The Treasury Department gives examples applying source-based rules: (1) income derived from use of intellectual property has its source in the location where the intellectual property is utilized, and (2) compensation for labor or personal services has as its source where the labor or personal services were used. Id.
94 See id. See also Benjamin and Nathanson, supra note 89, at 30.
95 See Department of Treasury, supra note 93. See also Cigler and Stinnett, supra note 80, at 59.
96 See Department of Treasury, supra note 93.
97 See Cigler and Stinnett, supra note 80, at 59.
III. TAXATION OF E-COMMERCE: THE KEY UNDERLYING ISSUES

A. A POTENTIALLY DECREASING TAX BASE

1. Displaced income

According to Arthur Cordell, of the Canadian Department of Industry, the “new wealth of nations” is to be found in the digital bits of information “pulsing through global networks.”98 The income flows occurring over the Internet are a new and potent source of potential government tax revenue.99 However, if the potential tax revenue from this new form of income is not captured, the overall tax base will be eroded by a “double whammy”: the total loss of tax revenue not collected, plus the loss of tax revenue from the income of workers displaced by new information technologies.100 The situation is most acute in Europe, which relies primarily on the “VAT” consumption tax for its tax base.101 The OECD estimates that half a billion European Currency Units will be lost by 2001 if the VAT is not applied to e-commerce transactions.102

2. Tax avoidance and compliance issues

A second form of tax base erosion may occur due to the ephemeral nature of global e-commerce transactions.103 Such transactions are exceedingly difficult to verify since they leave no physical record and may be conducted with electronic cash.104 An unfortunate

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98 See Arthur J. Cordell, New Taxes for a New Economy (visited October 3, 1998) <http://www.usask.ca/library/giv/v2n4/cordell/cordell.html> (originally presented September 14, 1995 at Victoria University in University of Toronto, before the World Leadership Conference). See also Arthur J. Cordell, Taxing the Internet: The Proposal for a Bit Tax (visited March 8, 1999) <http://www.arraydev.com/commerce/JIBC/9702-05.htm> (originally presented February 14, 1997 in a speech to the Harvard Law School). Cordell makes the case that, in a “global networked economy,” tax revenues are threatened as commercial revenues move to the Internet and are not recaptured by government authorities. Id. at 1. Cordell sees the Internet, however, as a vehicle for wealth creation, in a “New Economy,” and as an opportunity for governments to widen their tax bases. Id. Cordell gives the following as examples of companies that are thriving by transacting on the Internet: E*Trade, an online investing company with annual revenues of 68 million dollars; Amazon.com, an online “bookstore” with customers in 66 countries; and PhotoDisc, an online provider of digitized photographic images with 30,000 customers. Id. at 3-4.

99 See id.

100 See id.

101 See Strassel and Schenker, supra note 78; Christopher Deal, The GATT and VAT: Whether VAT Exporters Enjoy a Tax Advantage Under the GATT, 17 Loy. L.A. Int’l & Comp. L.J. 649 (1995). The “VAT” is the “value added tax,” a tax on the consumption side levied on goods and services. Id. at 650. The VAT is computed by taxing the value added to a good at each stage of production, usually at a flat rate—offsets are available at each stage to prevent double taxation. Id. at 650-51. See also Alan Schenk, The Plethora of Consumption Tax Proposals: Putting the Value Added Tax, Flat Tax, Retail Sales Tax, and USA Tax into Perspective, 33 San Diego L. Rev. 1281, 1290-1294 (1996) (providing a quick history of the use VAT and consumption taxes); Jennifer L. Schenker, E-commerce in Europe, Wall St. J. Europe, Sept. 7, 1998.

102 See Strass and Schenker, supra note 78.

103 See Charles Leadbeater, The Death of Taxes as We Know Them, Pittsburgh Post-Gazette, July 26, 1998 at El.

104 See id. See also Department of Treasury, Selected Tax Policy Implications of Global Electronic Commerce (1996). The Treasury Department sees a potentially increased role for issuers of electronic money in combating tax evasion and avoidance, since the issuers represent the “interface between the physical economy and the electronic economy.” Id. at 29. See generally Harvard Legislative Research Bureau, Remote Purchasing and Fundamental
consequence of this new technology, according to the OECD, is that the Internet may become a prime conduit for business tax avoidance. The OECD posits that if electronic cash is floating around the Internet, the lack of a paper trail would prevent tax authorities from conducting accurate audits.

This problem would be especially acute for countries which rely on consumption taxes for tax revenue, such as the “VAT” (value added tax). Since consumption taxes are a tax on sales, any lost taxes on undetected consumption of products conducted over the Internet would mean a proportional loss to the country’s tax base. Significantly, the value added tax is the single most important tax raising measure for all OECD countries, except Australia and the United States. In addition to lost income to government coffers, the Harvard Legislative Research Bureau argues that increased tax avoidance “dramatically affects” the fairness of the tax system and distorts economic decision making.

B. JURISDICTIONAL ISSUES: PROBLEMS IN DETERMINING PERMANENT ESTABLISHMENT AND APPLYING SOURCE BASED TAXATION PRINCIPLES TO E-COMMERCE TRANSACTIONS

With respect to e-commerce transactions, determining a taxable presence within a country may be a perilous proposition. According to the OECD, since Internet servers can be


106 See id.
109 Harvard Legislative Research Bureau, Remote Purchasing and Fundamental Fairness: The Sales and Use Tax Equalization Act, 35 Harvard J. Legis. 537, 537-38 (1998). The Bureau argues that differential taxing of goods and services obtained via e-commerce versus other conventional means (e.g., purchasing at a physical store) distorts economic decision making, since, ceteris paribus, the consumer will opt for the lower-priced product (after taxes). Id. at 538-39. The natural inference from this line of reasoning is that proposed taxes on e-commerce should be neither higher nor lower than existing taxes. If e-commerce taxes are higher relative to conventional means of obtaining goods and services, then e-commerce suffers, as consumers will choose the lower-priced conventionally-obtained product (and vice versa). See OECD, Electronic Commerce: A Discussion Paper on Taxation Issues, 4 (1998) (“[It is] important to avoid an unfair distortion of competition which would result from a de facto double or non-taxation of electronic commerce vis a vis fully taxed ‘traditional’ commerce carried out via conventional ‘physical’ means.”); Martin J. Moylan, Online Retailers May Have Tax Advantage, St. Paul Pioneer Press, October 31, 1998 at 1E (noting that because e-commerce transactions are currently untaxed, a member of the National Retail Federation decries the competitive advantage that e-commerce retailers such as Amazon.com (an e-commerce bookseller) have over traditional storefront retailers, who have to charge their customers a state sales tax).
110 See Thorpe, supra note 21, at 655. See also infra note 112; John F. Delaney and Adam Lichstein, The Law of the Internet: A Summary of U.S. Internet Caselaw and Legal Developments, 505 Practicing Law Institute 79, 156 (1998). The rise of Internet has also caused thorny problems Stateside in determining traditional personal jurisdiction analysis. Now, courts must consider to what extent “electronic contacts” should count in establishing a person’s “minimum contacts” in a particular state. Id. See, e.g., CompuServe Inc. v. Patterson, 89 F.3d 1257 (6th Cir. 1996), reh’g, en banc, denied 1996 U.S. App. LEXIS 24796 (6th Cir. Sept. 19, 1996) (quoted in Law of the Internet at 157) (where a defendant who had sent e-mail to plaintiff in Ohio was found to have maintained
located in multiple global locations, defining them as a fixed place of business could lead to inadvertent double taxation. The following hypothetical illustrates some of the problems inherent in a common e-commerce transaction:

A customer in Norway uses his computer to access a server located in India to purchase goods produced by a U.S. company. The U.S. company has no other presence in, or contact with, Norway or India. Under these circumstances, which country or countries may tax the U.S. company’s business profits on its sale to the Norwegian customer?112

As this example demonstrates, traditional physical presence or agency concepts of permanent establishment are difficult to apply within the realm of cyberspace. Several cogent issues arise. For example, does the presence of the U.S. company’s Web site on the Norwegian customer’s computer qualify as a permanent establishment in Norway, or can it be shown that the location of the U.S. company’s server in India qualifies as a permanent establishment? Finally, in applying source of income rules, where might one say that most of the economic activity concerning this transaction takes place—in Norway, in India, or in the U.S.? Obviously, there exists the contentious potential for multi-jurisdictional turf battles concerning the right to tax the company’s profits in the transaction.116
Since commerce in cyberspace transcends national borders and the fixed physical location of transactions, the U.S. Treasury has observed that source-based taxing schemes could be obsolete with respect to e-commerce.\textsuperscript{117} The Treasury has also indicated that residence-based taxing schemes should apply when the traditional concepts of permanent establishment and source-based taxation do not apply.\textsuperscript{118} The issue, of course, is whether there can be international coordination of such a regime, given that the great majority of companies conducting business over the Internet are American.\textsuperscript{119} Creating a regime may be difficult given that application of residence-based principles would mean that the United States would get to keep a large portion of e-commerce derived tax revenue. Additionally, international coordination of tax matters may be problematic, because no area of the law is closer to the subject of sovereignty than taxation,\textsuperscript{120} and countries are generally very reluctant to surrender their autonomy in this area.\textsuperscript{121}
C. THE “GOODS” VS. “SERVICES” VS. “INTANGIBLES” DISTINCTION

A key issue for properly taxing e-commerce transactions is how to categorize certain e-commerce transactions in which the end-product is received on-line (e.g., software, online information services, digitized images, and film and video output). \textsuperscript{122} According to the OECD, many goods once sold in physical format are now available on-line. \textsuperscript{123} Classification issues are critical because of the possibility of a differential tax impact, both under United States and E.U. tax laws. \textsuperscript{124} For example, a product imported into a country as a “good” may be subject to the VAT, rather than withholding taxes or income taxes, as long as the destination country does not have a permanent establishment in the country. \textsuperscript{125} An “intangible,” however, may be subject to withholding taxes on its royalty payments, but not subject to the VAT. \textsuperscript{126} Finally, a “service” may not be subject to any taxes at all, as long as the services are provided by a foreign company and are performed outside the country. \textsuperscript{127}

PART TWO: EXPLANATION AND ANALYSIS OF KEY CURRENT PROPOSALS FOR TAXING E-COMMERCE

I. DOES THE “BIT TAX” BYTE?

A. THE “BIT TAX” PROPOSAL

Perhaps the most controversial of the currently proposed e-commerce taxation schemes, the “bit tax” is a tax on the interactive digital traffic on the Information Superhighway. \textsuperscript{128} The tax would apply to all digital “bits” of information that flow through telecommunications traffic lines that carry interactive digital information. \textsuperscript{129} The tax would be applied on the flow volume

\textsuperscript{122} See Edward Morse, \textit{State Taxation of Internet Commerce: Something New Under the Sun?}, 30 Creighton L. Rev. 1113, 1130-38 (1997). In United States, only two states (Hawaii and New Mexico) apply the sales tax to services in addition to goods—a situation that Professor Morse says arguably could be classified as “discriminatory." \textit{Id.} The advent of digitized and other products delivered via e-commerce further muddies the issue. \textit{Id.}


\textsuperscript{125} See Cigler, Burritt, and Stinnett, \textit{supra} note 124, at 341.

\textsuperscript{126} See id.

\textsuperscript{127} See id.


\textsuperscript{129} See New Taxes, \textit{supra} note 128.
of bit data, and then collected by telecom carriers, satellite networks, and cable systems, who would send it directly to governments. In order to eliminate double taxation, the bit tax would only apply to value added portions of interactive digital transactions. Arthur Cordell, creator of the bit tax proposal, sees interactivity as making the transaction valuable, and, hence, taxable.

B. POSSIBLE BREACHES OF BASIC TAX PRINCIPLES

The main appeal of the bit tax is its ostensible simplicity—a specified tax rate is applied to the volume of interactive cyberspace “traffic” traveling over lines run by telecommunications carrier companies, and the resulting tax revenues then flow directly to national governments. However, such simplicity may be more apparent than real, for the bit tax presents vexing problems of how to accurately measure the volume of data flow and how to precisely separate which data is taxable and which is not. Consequently, tax collections could either be inflated or deflated, bringing unintended distortions in the tax base and instabilities in the tax system. Additionally, taxing business transactions in a different manner specifically because they are conducted by means of electronic commerce violates the principle of tax neutrality.

A distinguishing characteristic of the bit tax is that the entire burden of collecting and remitting the tax is borne by the carrier company. While it is arguable that carrier companies possess the necessary technical and labor resources to effectively perform such a function, it is uncertain who, in the final analysis, would shoulder the bulk of the tax burden or incidence. Would carriers absorb the cost, or would they pass it onto consumers? If carriers choose to pass the costs onto consumers (a reasonable assumption, it appears), they would have to do so in a non-neutral manner because carriers lack the means to accurately separate e-commerce from non-e-commerce data flows.

C. PROBLEMS WITH COMPLIANCE AND ENFORCEMENT

With a bit tax, there could also be problems with enforcing compliance on the part of carrier companies. Without a central international regulatory agency to oversee the carriers, there would be difficulties in ensuring that companies collect the correct amount of tax and accurately allocate the funds to the designated governments. Even if such an agency were created by international treaty or agreement, it seems doubtful that sovereign governments would accede to international jurisdiction and oversight over the activities of their key telecommunications corporations.

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130 See id.
131 See id.
132 See id.
133 See id.
134 See id.
135 See WTO Report, supra note 22.
136 See New Taxes, supra note 128. This paper uses the term “carrier company” as an all-encompassing phrase including telecom carriers, satellite network providers, and cable system operators.
137 See id.
138 See id.
So, why not have the carrier company’s host country enforce bit tax regulations on the carrier? This sounds feasible at first, but deeper inquiry suggests it would not be. Presumably, any practical form of the bit tax would be some sort of consumption-based tax. Since, in many e-commerce transactions, the country of consumption may not necessarily be the carrier company’s host country, there would be little economic incentive for the carrier’s host country to expend economic and labor-power resources to monitor the carrier’s e-commerce tax collection and allocation activities.

II. THE EUROPEAN E-COMMERCE VAT PROPOSAL

A. HOW THE EUROPEANS WANT TO TAX E-COMMERCE

In the European plan, software manufactures would be required to devise a method to keep track of e-commerce sales. Banks would then process the transactions, withhold taxes from the sales, and pass the proceeds onto the appropriate government. Banks could offer such a service for fee to clients, and national governments would help banks defray part of the collection costs. In order to adhere to the principle of tax neutrality, the E.U. has proposed classifying e-commerce “virtual goods” as “services.” This distinction is important because E.U. VAT legislation taxes goods and services differently. Current E.U. VAT tax laws provide that the sales of services within the E.U. would be subject to tax, but the provision of services from within the E.U. for consumption outside the E.U. would not be taxed. Adaptation of current VAT rules, then, means that the sales of e-commerce products within the E.U. for consumption within the E.U. would be subject to E.U. VAT taxes, but sales from the E.U. of e-commerce products for consumption outside the E.U. would not be subject to the VAT.

139 See Schenker, supra note 101; See also Anne Marie Roussel, Don’t Let VAT Stymie Your Commerce Plans, Internet Week 31, November 2, 1998.
140 See id. See also John Kennedy, Taxing the Net: The European Union is Keen to Implement a Framework for Applying VAT on Internet Transactions, Business & Finance, October 22, 1998. At a recent OECD meeting, considerable opinion existed among governments that e-commerce transactions should fall under the ambit of existing VAT, customs and excise taxes. Id. at 2.
141 See Schenker, supra note 101.
142 See Kennedy, supra note 140, at 2. See also Tax-free E-commerce, Accountancy, August 1, 1998.
143 See Kennedy, supra note 138, at 2.
144 See generally Tracey A. Kaye, European Tax Harmonization and the Implications for U.S. Tax Policy, 19 B.C. Int’l & Comp. L. Rev. 109 (1996). The European Community has been intensely at work in the late 1990s attempting to attain a harmonization its members’ corporate tax laws, in anticipation of the single, integrated European Market. Id. at 110-11. An example of these efforts has been the recent “VAT simplification” Directives, aimed at improving internal market functioning by reducing complexities in the current E.U. taxing system. See VAT Simplification, 1 Colum. J. Eur. L. 555, 555 (1996). The VAT has been the object of primary focus in EC’s efforts, because of the VAT’s key role in “partly financing the Community itself.” Kaye at 110-11. With the formation in 1994 of the European Economic Area (EEA), the EEA became the world’s largest free-trade zone, comprising a single market of 370.5 million people. Id. at 112-13. The implications of these developments is that the United States must be increasingly global in its outlook, and ever-aware of the economic movements of its global counterparts. Id. at 114-15.
145 See Kennedy, supra note 140, at 2.
146 See id. See also OECD, Dismantling the Barriers to Global Electronic Commerce, Background Paper for the Turku Conference (1997). The OECD states that, “electronic commerce raises particularly difficult questions for VAT, as the vast majority of services concerned are normally taxed at a positive rate of VAT when supplied for domestic consumption and at a zero rate for export. The VAT rules governing accountability of international
B. ADVANTAGES OF THE EUROPEAN PLAN

The main hallmark of the European plan—the adaptation of an existing VAT consumption-type tax to e-commerce transactions—preserves the principle of tax neutrality, with minimal disruption expected for most of the world’s current tax regimes. Additionally, because banks and service providers collect and disburse tax funds, there are no apparent procedural inconveniences for e-commerce businesses and their customers with the implementation of the tax.

C. THE PIVOTAL ROLE OF BANKS IN THE EUROPEAN PLAN

As presently framed in the E.U.’s proposal, banks play the pre-eminent role in the plan. This raises several troublesome issues. Because banks would collect and disburse e-commerce tax revenues to the appropriate governments, they would perform an essentially governmental administrative function. Banks, however, are not governmental agencies, nor even pseudo-governmental apparatus. Since banks would be motivated by the desire to increase the volume of e-commerce transactions processed (to garner greater fees from taxes collected), an inherent conflict of interest would be created if banks are also vested with the responsibility of allocating tax funds. The danger lies in the potential for fraud and abuse in the handling and disbursement of tax revenues by banks. As was noted previously, e-commerce transactions are projected to grow to $US 1 trillion dollars with the next few years, and concomitant consumption taxes could equal literally hundreds of billions of dollars per annum. With such a high flow of tax revenue, strict auditing and monitoring controls would be essential for maintaining integrity of the system.

Additionally, any international e-commerce VAT system could conceivably involve hundreds of tax rate schedules and protocols with which participating banks must comply. Thus, aside from the potential for bank fraud and abuse, it would also be difficult to know whether banks are accurately and timely allocating tax funds to governments. Confusion could arise if a relatively large number of banks are collecting and allocating funds to many countries. Different banks from different regions or countries could have differing turnaround times in disbursing tax funds, creating timing expectation problems for countries that are acutely reliant on consumption services have therefore always posed problems for tax administrations. Such problems are greatly amplified for e-commerce services . . . [f]or VAT, “place of supply” for electronic commerce may come to be the place where the service is consumed.” Id. at 19. It appears that the E.U., with its e-commerce proposal, has conceded the OECD’s last point.

147 See Schenker, supra note 101. See also Kennedy, supra note 140, at 2. Elizabeth Olivi, spokesperson for Mario Monte, E.U. Tax Commissioner, stated the importance of not introducing new taxes and adapting existing taxes, particularly the VAT, for taxing e-commerce transactions. The new system must be neutral, asserts Olivi, so that e-commerce taxes will not distort competition. Id.

148 The VAT, a form of consumption tax, is the single largest source of tax revenue for all OECD countries, except the U.S. and Australia. See Schenker, supra note 101.

149 See id.

150 See Scoffield, supra note 12, at B6.

151 Since VAT rates in the E.U. range from 16% to 25%, consumption tax revenues could reach $US 160 to 250 billion dollars per year, assuming projections of $US 1 trillion in e-commerce sales prove true. See Schenker, supra note 101.
taxes for their tax base. An international regulatory agency could conceivably be created to oversee and organize banks’ activities, but resource and jurisdictional problems would be difficult to surmount.\footnote{See Reuters, \textit{EU Seeks to Tax E-commerce}, (visited September 23, 1998) \url{<http://www.news.cnet.com/news/Item/0-1005-200-33082.html>}.}

Another major area of concern with the European plan involves the selection of participating bank institutions. The work of collecting, processing, and disbursing tax funds would require the careful selection of banks that possessed the requisite financial, technological, and organizational capabilities. The situation could become precarious if a participating bank became financially troubled or insolvent while holding countries’ e-commerce tax funds during the collection process. The issue is especially germane and critical given the current unstable global economic and banking environment.\footnote{See Lawrence L.C. Lee, \textit{The Basle Accords as Soft Law: Strengthening International Banking Supervision}, 39 \textit{Va. J. Int'l L.} 1, 1 (1998). With the advent of economic globalization and the trend of deregulation and multinationalization of banks and financial institutions, the risk increases significantly for international financial crises. \textit{Id.} at 2. It is feared, for example, that the recent Asian financial crisis could have spillover effects for the world economy. \textit{Id.} See also Daniel M. Laifer, \textit{Putting the Super Back in the Supervision of International Banking, Post-BCCI}, 60 Fordham L. Rev. S467, S467 (1992) (stating banking regulators will be called on increasingly to respond to the “highly mobile, innovative, and risky financial environment”); John H. Chun, \textit{“Post-Modern” Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?}, 64 Fordham L. Rev. 2647, 2650 (1996) (indicating the Mexican banking crisis has been termed by commentators as the first example of what can go wrong in the post-modern, globally interconnected banking and financial system).}

D. THE BURDEN ON SOFTWARE MANUFACTURERS AND SERVICE PROVIDERS

Since software manufacturers and service providers have the task of tracking e-commerce sales, they too, have a high burden under the European proposal.\footnote{See Schenker, \textit{supra} note 101; Anne Marie Roussel, \textit{Don’t Let VAT Stymie Your Commerce Plans}, Internet Week 31, November 2, 1998.} Presumably, the software manufacturer/service provider would have to rewrite their software codes to accommodate the new tax requirements,\footnote{See Roussel, \textit{supra} note 154, at 1. Presumably, such a high burden would not be popular with software manufacturers and service providers. \textit{Id.}} and would then be required to give detailed information on e-commerce transactions to banks. An issue arises regarding who would ultimately absorb the cost of the information gathering—the provider or the consumer? If the consumer absorbs the cost, then he or she would be subject to a “double whammy”—the tax plus the added cost of the provider’s responsibility to track sales. Furthermore, it is arguable whether adequate incentive would exist, absent fear of government sanction, for the provider to give accurate and timely transaction information to banks. Are governments prepared to expend the necessary resources to oversee and enforce provider compliance under the plan? Do governments have incentive to do so? These are all important questions to address and answer before the E.U. plan could be successfully implemented. Finally, the E.U. plan appears to raise serious privacy issues,\footnote{See \textit{id.}} since information on consumers would pass through two channels—the software manufacturer/service provider and the bank who handles the tax processing.\footnote{Since one of the E.U.’s primary concerns is data privacy for consumers, it appears that the European VAT proposal contradicts an E.U. priority.}
III. THE CLINTON ADMINISTRATION’S E-CARD PROPOSAL

A. HOW THE CLINTON ADMINISTRATION WANTS TO TAX E-COMMERCE

The Clinton Administration has recently proposed a high-tech variant of the traditional VAT taxing scheme. Consumers would purchase digital cash cards (also known as “smart cards,” or “e-cards”) at banks that would allow the seller to identify the country the purchase was from. The VAT would be calculated, based upon the place of consumption, and immediately collected with the sale. The funds would then be placed by the seller with a third party escrow agent, who would funnel the money to the appropriate government. It is estimated that governments could receive their funds weekly, instead of the two to four months it now takes governments to collect the VAT.

B. CLINTON PROPOSAL

The Clinton e-card proposal presents several distinct advantages. First, as with the European plan, the e-card plan is tax neutral. As opposed to the bit tax, e-commerce transactions under the Clinton plan would not be taxed differently than other business transactions. And, since the e-card proposal is a VAT consumption tax, the E.U. countries could maintain tax consistency, and the United States and Australia could tax e-commerce transactions as they currently tax sales transactions.

Another advantage of the Clinton Administration’s plan involves the creation of an escrow agency. By centralizing the “funneling” of tax revenues to appropriate governments through an escrow agent, the plan provides for greater consistency and predictability than the European plan, which calls for an indeterminate number of private banks to perform the same

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158 See Strassel, supra note 78.
159 See Department of the Treasury, Selected Tax Policy Implications of Global Electronic Commerce, §8.4 (1996) (if the cash cards operate as intended, they are “likely to represent an important means by which taxpayers and tax administrators can prove the identity of electronic counter parties”). See also John K. Sweet, Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles, 146 U. Pa. L. Rev. 1949, 2006 (1998) (a “smart card” would be used by an e-commerce consumer, which would have information about the consumer’s residence); Kerry Lynn Macintosh, How to Encourage Global Electronic Commerce: The Case for Private Currencies on the Internet, 11 Harv. J.L. & Tech. 733, 734-35 (1998) (commenting on President Clinton’s e-card proposal and on “smart cards” embedded with a microchip that can be used for making e-commerce purchases). See generally Thomas W. Beetham, The Community Reinvestment Act and Internet Banks: Redefining the Community, 39 B.C. L. Rev. 911, 911 (1998) (commenting on the rapid development of new technologies that are affecting the way financial institutions and banks do business—for instance, cards that enable Internet users to type an access code and download money into the computer).
160 See Strassel, supra note 78.
161 See id.
162 See id.
163 See id.
164 See id.
165 See Strassel, supra note 78.
166 See id.
Also, governments can deal with one centralized body in case any disputes, concerns, or queries arise over the processing of tax transactions. Governments can readily learn one agency’s dispute and query protocols, instead of dealing with a disparate number of banks.

A third advantage of the e-card plan is that it does not call for a source-based approach to taxing e-commerce tax revenues. This should ease the concerns of developing countries, since the e-card plan is a residence-based plan and rewards developing countries when its residents conduct business with residents of other countries.

Finally, the e-card helps preserve the privacy of consumers, a thorny issue with the E.U. countries, and a weakness of the aforementioned European VAT proposal. The e-card’s only “identifier” is the country of origin of the purchase. Otherwise, it appears the e-card is much more like cash, and much less conspicuous than a check or credit card.

C. THE SELLER’S SIGNIFICANT ROLE

Because the seller is responsible for collecting the tax funds, the seller assumes a prominent role in the Clinton e-card plan. The seller’s task under the Clinton plan is analogous to that of U.S. employers’ roles in calculating, collecting, and remitting employee payroll taxes to the Internal Revenue Service. Thus, the same sorts of compliance and

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167 See Schenker, supra note 101. Recall also that the Clinton Administration estimates that countries could receive their tax revenues weekly, instead of the two to four months it takes governments to collect the VAT. Strassel, supra note 78. This speed would afford countries enhanced cash flow access and allow for improved financial projection analysis. See also John K. Sweet, Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles, 146 U. Pa. L. Rev. 1949, 2007 (1998) (indicating the efficient allocation of tax revenues of the Clinton e-card proposal should be well-received by both developed and developing nations).


169 See id.

170 See generally Mark E. Budnitz, Privacy Protection for Consumer Transactions in Electronic Commerce: Why Self Regulation is Inadequate, 49 S.C. L. Rev. 847 (1998). American consumers share Europeans’ wariness of conducting transactions on the Internet. A 1997 Harris survey found that a “majority” of consumers are worried about the confidentiality and security of engaging in online activities and Internet transactions and “do not trust online and Internet service companies.” Id. at 849-50. Consequently, argues Professor Budnitz, e-commerce will be successful only to the extent of consumer confidence, and government regulation is an “important step” in promoting electronic commerce. Id. at 884-85. Furthermore, argues Budnitz, industry self-regulation is an “in-adequate substitute” for legislation with respect to matters of e-commerce privacy and security. Id.

171 See Schenker, supra note 78.

172 See id.

173 See, e.g., Keith Benes, David Gallai, Louisa J. McGruder, Anne M. Petersen, Tax Violations, 35 Am. Crim. L. Rev. 1219, 1241-42 (1998). Under federal income tax provisions, employers are required to submit the following payroll taxes: FICA payments, FUTA payments, and required withholding in connection with employee income taxes. Id. (quoting JOHN J. TIGUE, JR. & LINDA A. LACEWELL, THE WAGES OF SIN: THE IRS LOOKS AT OFF-THE-BOOKS PAY, at 3 (1996)). The Internal Revenue Code provides that “whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax collected or withheld shall be held to be a special trust fund in trust for the United States.” I.R.C. §7501. See also Benes at 1241-42. Thus, the employer is deemed a “trustee” of the collected or withheld tax funds. Id. Analogously, the seller, under the Clinton e-card plan, could also be deemed a “trustee,” and would bear substantial burdens for compliance. Under the Internal Revenue Code, employees face substantial civil and criminal penalties for non-compliance. See, e.g., I.R.C. §§7201, 7202, 7203, 7206, and 7212(a); Benes at 1220. Similar legislation would have to be passed by Congress regulating the seller’s role under the Clinton plan. It is plain that
enforcement issues arise under the e-card plan as do under the collection of U.S. payroll taxes. For example, the potential exists for the e-commerce seller to simply keep the tax proceeds and not forward them to the escrow agent.174 Who will enforce compliance on sellers? The seller’s host country will probably not want to expend resources for enforcement and monitoring. A corollary of this concern is the issue of securing compliance from sellers in developing countries. There could be difficulties in obtaining cooperation from the host country in the case of non-compliant sellers.

Similarly, an issue arises as to who will bear the burden of the extra costs of seller compliance under the plan. As with the European plan, consumers could face a “double whammy” of increased costs for e-commerce products in addition to the consumption tax. This could be a significant damper on the growth of e-commerce.

D. THE ESCROW AGENT’S ROLE

Since the escrow agent may be funneling billions of dollars to governments annually, it plays a critical role in the Clinton Administration’s plan. The credibility and stability of the agent is a key factor in establishing government confidence in the e-card system, allowing governments to feel secure in entrusting the escrowing of their valuable tax revenues to a outside party. There are two crucial unanswered questions in this regard: (1) who will be selected to be the escrow agent, and in which country will the agent be located, and (2) how will the agent’s activities be monitored to ensure the accuracy and integrity of its performance? Some ideas for further discussion, with respect to handling these issues, are included in this note’s proposal, infra.

E. CONCERNS OVER E-CARD TECHNOLOGY AND CONVENIENCE

Since, under the Clinton proposal, consumers would be required to purchase the e-cards at banks, a legitimate concern is raised about whether this inconvenience would be enough to stymie consumers’ appetites for e-commerce transactions. Would the e-card requirement retard e-commerce growth? This author hypothesizes that such a requirement would not, in the long run, retard the development of e-commerce. Once a “critical mass” evolves on the Internet, where significant products, goods, and services are conveniently available on-line, it is not difficult to envision consumers purchasing e-cards as a matter of routine. The key requirement would be that sufficient goods and services be available on-line, and with sufficient convenience that consumers would view the use of e-commerce as providing net benefits compared to such an undertaking would require significant intra-governmental cooperation, but also planned coordination between national governments.

174 See Benes, supra note 173, at 1241-42. An analogous situation exists with current employer payroll taxes. Because employers only need remit withheld payroll taxes on a quarterly basis (see Treas. Reg. §§31.6011(a)-1, 31.6011(a)-4, quoted in Benes, footnote 160), unethical employers face a “strong temptation” to use payroll tax funds for their own business or personal purposes. Id. However, the situation may be less critical under the Clinton plan, because the plan calls for weekly disbursement by sellers of collected tax funds from consumers. Nonetheless, unethical e-commerce sellers would still face the temptation of keeping tax funds earmarked for allocation to national governments. See also this note’s proposal for a recommendation on this issue. See generally Kirsten Harrington, Employment Taxes: What Can the Small Businessman Do?, 10 Akron Tax J. 61 (1993) (citing the burdens that the small businessperson faces with respect to the collecting, withholding, and filing of payroll taxes, and the Internal Revenue Service’s escalated efforts to enforce such filings).
traditional means of purchasing goods and services, such as driving to a store or ordering products by mail-order.175

Another area of concern could be the integrity and security of the e-cards themselves, and whether the cards would be subject to possible fraud and abuse.176

PART THREE: A PROPOSED REGIME FOR TAXING E-COMMERCE

This note recommends that the Clinton Administration’s VAT e-card proposal be adopted, with some modifications and edifications.

The first recommendation is that an international e-commerce “taxation agency” should be created in order to: (1) oversee the proposed e-card taxation regime and, perhaps, report to an international economic organization, such as the WTO, OECD, or UNCITRAL. It is important that the agency be under the aegis of a respected international body, to lend credibility and influence to the new agency; (2) manage and implement new e-card and other e-commerce technologies that could improve the system; (3) coordinate and manage the separate consumption taxing schedules of the various countries, to ensure that each country receives its proper and correct share of e-commerce tax revenues from the escrow agent; (4) monitor and audit the activities of the escrow agent—especially in regards to the accurate and timely allocation of tax funds to their appropriate countries. The agency will help to decrease the likelihood of abuse and fraud on the part of the escrow agent; and (5) oversee and manage the wholesale distribution of e-cards.

Because the financial strength and solvency of the escrow agent is of utmost importance, the United States and E.U. should take a leading role in the selection of the agent.177 Perhaps an international bank, similar to the IMF, could be created solely for the responsibilities of escrowing and distributing the funds. In this case, the tasks and responsibilities of the escrow agent merges with that of the agency proposed above.

175 It may be instructive to compare the e-card to similar inventions, such as bank ATM cards, credit cards, and long distance calling cards. Consumers appear to view the use of such inventions as time-saving, convenience devices. If the quality of products and services, and the convenience of e-commerce is high, then consumers may view the purchase and use of e-cards as a relatively trivial expense of effort. Thus, this author believes that the requirement of e-cards would not, in itself, and in the long-run, be a determinative factor in consumers deciding not to use e-commerce. In the short run, however, it may very well be that the e-card requirement will be a hindrance to consumer acceptance of e-commerce.

176 See also Department of the Treasury, Selected Tax Policy Implications of Global Electronic Commerce (1996), §8.4 (discussing some of the issues involving e-card security); Kerry Lynn Macintosh, How to Encourage Global Electronic Commerce: The Case for Private Currencies, 11 Harv. J.L. & Tech. 733, 737-38 (1998). Developers of the new smart cards are adapting existing technologies, such as magnetic stripe cards and credit cards to e-commerce. Id. Thus, perhaps current solutions to the problems of fraud and security with existing technologies could also be applied to the new e-card. In any event, it appears reasonable to assume that the potential for fraud and security breaches with the e-card would not be any greater than currently exists with credit cards and the like.

177 This is because of the relative strength and stability of financial institutions in the United States and European Union. See, e.g., Daniel Laifer, Putting the Super Back in the Supervision of International Banking, Post-BCCI, 60 Fordham L. Rev. S467, S499-S500 (1992) (illustrating the emphasis that the United States and EC countries place on regulation of banks and financial institutions).
This note’s second recommendation is that agreements between national governments should include provisions that each government commit to passing regulations designed to enforce and monitor compliance of sellers that are residents of the country. Such regulations should outline the requirements of sellers in collecting and withholding tax funds from the e-commerce transactions in which it participates, and also detail the domestic agency that would be responsible for domestic compliance issues. Additionally, this note suggests that a fund should be set up, with contributions from the wealthiest countries, to help all Internet retailers defray the costs of compliance. Also, the GATT countries should agree to commit adequate money and resources to enforce Internet retailer compliance with respect to submitting proper tax proceeds to the escrow agent.

Finally, with respect to the e-cards, this note recommends that further research should be done to find ways to more widely distribute the e-cards, in addition to having them available for purchase from banks. Perhaps, the e-cards could also be sold online over the Internet, from established retail outlets, such as computer and office supply stores. This will lessen inconvenience for consumers and cause less of a drag on e-commerce growth in the short run. Also, software should be researched, developed, and provided to sellers that would enable sellers to quickly calculate taxes owed, according to the tax rate schedule of the country of the consumer. Finally, software should be researched and developed that is embedded with anti-fraud and anti-tampering capabilities to reduce incidents of seller fraud and noncompliance.

Since the developed nations are the wealthiest countries, and currently have the biggest stake in seeing e-commerce develop, it appears equitable for these countries to shoulder the greatest burdens in financing and coordinating the recommendations as set out above. However, since the ultimate success of global e-commerce will most likely rely in part on the goodwill and resources of developing countries, it is suggested that most planning, negotiations, and implementation of this Note’s proposals be coordinated under the watchful eye of a respected international organization (such as the OECD or WTO), where the voices and concerns of the developing nations could be given a forum for expression.

PART FOUR: CONCLUSION

Electronic commerce has grown tremendously in a short time, and is forecast to grow even more in the near future. A coordinated and consistent global tax policy is a rational response to the issue of how to manage valuable tax revenues from this new transactional medium. This Note recommends that the Clinton Administration’s e-card plan be adopted, with a few modifications. While not a perfect plan, this proposal improves upon the strongest of the three major plans currently being scrutinized by the international tax community. The creation of an international monitoring bureau and centralized escrow agency, as well as the wider distribution of e-cards to consumers, will maintain a feasible balance between tax compliance objectives and a practicable level of transactional freedom that should leave e-commerce growth levels unfettered.

178 It would appear prudent, for instance, for the Treasury Department to assume such responsibilities in the United States, since the Treasury Department is already charged, via the Internal Revenue Service, with the enforcement of federal tax laws.