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Should E-Commerce and Digital Trade Be Taxed?

Introduction

Digital trade and e-commerce are increasingly powerful drivers of business and trade in the global economy. In the United States alone, e-commerce generated US\$2,198 billion for wholesale industry (up 1.9% from 2014), US\$340 billion to retail industry (up 14%), and US\$550 billion for selected service industries (up 7.4%) in 2015.ⁱ

In 2013, the OECD reported that the “internet economy” - “the full range of our economic, social and cultural activities supported by the Internet and related information and communication technologies” - generated 3.6% of Australia’s GDP in 2011, 6.6% of Sweden’s GDP in 2011, and 7.2% of the UK’s GDP in 2010.ⁱⁱ

From 2010 to 2016, the size the internet economy of the G20 nearly doubled and it has created jobs for 32 million people today.ⁱⁱⁱ

Much of this growing commerce has taken place without cross-border taxes being applied due to technical constraints in implementation. The consequences of not taxing e-commerce and digital trade are increasingly being felt by governments, who believe they stand to lose revenue,^{iv} and by traditional offline businesses whose transactions are taxed.

Increasingly, governments around the world are seeking to minimize projected losses and capitalize on the flourishing internet economy by taxing e-commerce transactions. Through changing tax rules, some governments are aiming to increase revenues and equalize what they see as unfair opportunities between online and offline businesses.

This policy paper addresses this growing trend in trade policy. By examining recent proposals on foreign incoming low-value goods, this paper outlines some necessary considerations in taxing e-commerce and potential problems that all parties in international trade - buyers, sellers, service providers, and governments - may face in the process.

While taxing e-commerce and digital trade may seem to be simple solution to the apparent loss of revenue faced by governments, unless handled very carefully, the cure may be worse than the problem. The benefit of e-commerce is that every firm has the potential to become a multinational and find customers globally. Taxation policies run the risk of destroying these opportunities, especially for the smallest companies.

E-commerce and digital trade transactions

For every internet-facilitated transaction, sellers, buyers, service providers, and governments interact with one another. *Sellers* offer goods and services to *buyers*, who may be both individuals and other businesses. *Service providers* facilitate transactions by “providing knowledge and technology for running the electronic commerce,”^v including e-commerce platforms and online payment services such as eBay and PayPal. *Governments*, including local and national governments, control who gets taxed, how much to tax, and who collects the tax.

In order for taxation to maximize revenue for governments while minimizing costs for sellers and buyers, experts recommend that tax rules should abide by the following principles:



- *Neutrality*: tax rules should not privilege any form of commerce over another;^{vi}
- *Effectiveness*: tax rules should prevent double taxation and tax evasion by individuals and firms;^{vii} and
- *Efficiency*: tax rules should minimize administrative and law-compliance costs.^{viii}

Implications of International Taxation

The internet enables businesses that set up shop online to conduct transactions remotely and connect with sellers, buyers, and partners worldwide, creating possibilities unavailable to traditional, physically-based businesses. However, these possibilities complicate efforts to generate tax revenues from online-business profits efficiently, effectively, and equitably.

Disagreements arise on which parties should bear tax burdens. Disagreements have arisen early in the transaction process as to whether the tax burden should lie upon consumers or producers. Some argue that taxation should occur as a consumption tax “where the consumption takes place.”^{ix} If taxes are levied on producers, as a value-added tax,^x the question that arises is whether it is appropriate to tax the service provider facilitating the transaction and/or the seller.

Taxing producers selling abroad risks double taxation and actually creating an “unlevel” playing field. For example, in the case where a vendor selling goods abroad through e-commerce is taxed by the foreign government, vendors face both domestic income taxes and foreign income taxes. Absent additional provisions and rules to prevent such double taxation, this puts vendors with international businesses at a competitive disadvantage instead of leveling the playing field with traditional, non-online businesses.

Current framework of international taxation inadequately accounts for non-physical commerce. Current models and principles of international taxation are contingent on the physicality of the traditional business model, and thus leave many questions as to how digital trade and service transactions – which are non-physical by definition – should be regulated.

Differing tax systems between governments encourages tax evasion strategies. If governments do not implement e-commerce taxation in the same manner, competitive disadvantages will arise depending on whether taxes are placed upon consumers or producers. Should consumption be taxed, some consumers may be favored over others, especially if consumers are located in jurisdictions with no such e-commerce tax. Should production be taxed, producers may simply relocate business operations, in part or entirely, to tax havens where e-commerce proceeds untaxed.^{xi}

Complications and complexities of an e-commerce and digital tax *discourages online business and investment*, as taking the time to learn about the new taxes, paying for them, and filing the necessary paperwork to complete the process places high additional costs to companies. This is especially disadvantageous for micro, small, and medium enterprises (MSMEs), who already report increased difficulties and negative experiences with tax authorities.^{xii}

Taxing E-commerce: The Case of Australia

Australian small businesses contributed one third of total industry value added to the economy in 2013-14.^{xiii} The importance of small businesses has always been the focus of policy makers, not only in Australia but also the rest of the world.

The growth of digital trade and e-commerce in the past decade has enabled small businesses to get access to a larger pool of potential consumers from different markets. This opportunity, however, is not equally spread amongst all small businesses. Small firms who do not have enough capacity to export or who are still operating a traditional business model can find it difficult to compete in the digital economy.

There are a number of reasons why the competitiveness level of these small firms is negatively affected. One of the greatest concerns amongst Australian small businesses is the payment of Goods and Services Tax (GST).



Most offshore suppliers of small value goods are not paying Australia's domestic tax for goods and services they shipped to Australian customers. This partly contributes to the competitive price they can offer to customers in Australia who are increasingly shopping online. The GST of 10% can be significant for low value goods that often have low profit margins.

As a response to Australian businesses' growing concern on this issue, on 16 February 2017, Australia introduced important amendments to the laws on Goods and Services Tax (GST). Under these changes, low value goods up to \$1,000 imported into Australia from overseas will also be subject to GST.

The new legislation requires overseas suppliers including vendors, electronic distribution platform operators, and re-deliverers to register, collect and pay GST for low value goods that are shipped to Australian consumers if their turnover reaches \$75,000 per annum or more.^{xiv}

As this was too difficult for the Australian Government to figure out who should collect GST, the implementation of this new regime has been delayed by the Senate until 1st July 2018. The Productivity Commission will conduct a review of alternative tax collection models with a first report due by 31 October 2017.

Current Situation

Low value goods (with a customs value of under \$1,000) are not subject to GST when being shipped to Australian consumers from overseas. For those offshore goods whose value is \$1,000 and more, the consumer or purchaser of the goods is only liable for GST if the supplies are considered as having connection with Australia.^{xv}

Important Changes Under Australia's New Tax Regulation

- Suppliers of low value goods (valued at \$1,000 or less) from overseas to Australian consumers will be considered as "connected with Australia."
- The operator of an electronic distribution

platform (EDP) will be treated as the supplier of an inbound intangible low value consumer supply from offshore to Australian consumers that is made through that platform. As a result, the operator is responsible for paying GST for that supply.

- A supply of low value goods will be considered as an offshore supply of low value goods (customs value is \$1,000 or less) if it is brought into Australia, to a consumer, through an electronic distribution platform or by redeliverers.^{xvi} The operator and redeliverer are treated as the supplier of the offshore supply of low value goods.
- Non-resident suppliers will be allowed to elect to access the simplified registration and reporting system if their low value goods are connected with Australia. This simplified GST registration system can be done online with minimal information.^{xvii}
- GST will be applied on services and digital products (anything except goods or real property) such as architectural, legal services, or downloaded movies, games and electronic books. The operator of the EDP through which these services and digital products are sold will be responsible for registering, reporting and paying the GST.^{xviii}

Potential Impacts on Consumers and Offshore Suppliers

The new tax regulations will create a number of potential issues for offshore suppliers who are selling to Australian consumers.

First, the entity that is deemed to be the supplier of a sale of goods into Australia, and hence liable for paying GST – the seller, the EDP operator or the redeliverer – will need to carry out additional administrative procedures. This includes carefully keeping track of their sales to Australia, making sure these sales are made to Australian consumers, and forecasting their annual sales to see if they will exceed the GST registration threshold of \$75,000.

These will not only incur extra costs for firms but also pose additional risks for firms in their pricing strategy because it requires a fairly accurate



estimation for the period of one year ahead. For big firms who have in-house staff that specialize in this area or who have partnership with tax firms, the additional requirements could be manageable and bearable. However, for smaller firms that have limited manpower and expertise on tax issues, these new procedures could be destructive to their business.

Second, the implementation of the new system will require offshore suppliers to track down and collect more information for their sales, including whether or not the sales are made to Australian consumers and additional information concerning the supply of the goods.

The amount of paperwork required could be significant and challenging to collect for firms, especially when there is no available online portal where this information can be gathered and the level of harmonization across countries in terms of product origins is very low. These could then become an invisible obstacle for companies when considering exporting to Australia. The challenge for the government's tax officers will also be significant as they attempt to monitor such a system.

Third, for the operator of EDP such as eBay, making them liable for the tax that is incurred from small value sales made by vendors and consumers through their platform is problematic. The money from these transactions is not always collected by the EDP operators but more often by other payment companies such as PayPal.

Charging the EDP operators the GST for low value sales that are made through their platform will require these platforms to develop new systems to collect tax and new pricing strategies to protect themselves from additional costs without harming the small vendors and consumers who are using their platforms. However, the most likely scenario following this new tax regulation could be that the additional charge will then fall on the consumers or the suppliers.

Fourth, once the government has decided to impose tax on offshore low value goods, sellers will have to raise the prices of their goods and services to offset

additional costs. Whether the tax is imposed directly on the seller of the goods or the platforms where the purchase of the goods is made, the extra cost will eventually cause the seller or the EDP operators to increase prices, placing higher costs for goods and services on consumers in the end even if they are not directly taxed.

Taxing E-commerce: Other Countries

Though Australia is the first government planning to tax low-value imports that are related to e-commerce, governments around the world have recently made significant moves to begin the taxation of digital trade. In particular, governments are starting to tax electronic services ("e-services") internationally.

Among the earlier movers is South Africa, which placed a tax on e-services effective June 2014. Equally affecting business-to-business (B2B) and business-to-consumer (B2C) transactions, the current value-added tax of 14% is levied upon foreign suppliers that make profits exceeding ZAR50,000 from (1) supplying e-services to South African residents, or (2) receiving payments for supplied e-services through a South African bank. Taxable e-services include: educational services, games and games of chance, internet-based auction services, digital media, and subscription services.^{xix}

In South Korea, effective 1 July 2015, a similar value-added tax of 10% is levied upon supplies of e-services from non-resident suppliers and third-party service providers facilitating transactions and purchases. The tax is levied at the earlier point between purchaser's collection of the e-service and purchaser's completion of payment. Equally affecting B2B and B2C services, this legislation requires non-established companies to register to sell to South Korean residents, making them liable to the VAT.

The Korean legislation, therefore, requires firms to register in South Korea to sell services in the country. To be fully compliant with the law, smaller foreign firms are unlikely to deliver to the growing and lucrative digital market in Korea because they



will probably not take the necessary steps to register and pay VAT.

In Japan, effective 1 October 2015, foreign suppliers can voluntarily register with the National Tax Agency to be liable to the Japanese Consumption Tax (JCT) now levied on consumers of e-services based on the consumer's address. Consumer address is determined through "reasonable and objective means" such as the address of the credit card or billing address. For B2B transactions, Japanese businesses are required to file and pay taxes for receiving foreign-supplied e-services in a process called the "reverse charge mechanism." For B2C transactions, service providers are required to file and pay taxes, while customers of registered suppliers can claim purchase tax credits.^{xx}

In 1 March 2017, the Bangkok city government proposed to impose taxes on revenues from digital marketing and advertising from inside and outside of Thailand beginning April. The aim of the city government is to boost annual VAT revenues, currently at 300 million baht, to 100 billion baht by 2020 from an e-commerce industry that made 2.5 trillion baht in 2016 alone.^{xxi}

Singapore and Proposed Changes for GST System Targeting Low Value Goods

In Singapore, the sales of physical or digitized goods via the internet are currently subject to GST if the goods are supplied locally. This also applies to computer software including standard and customised software unless it is under contract with or related to customers living outside Singapore.^{xxii}

In May 2017, Singapore government began soliciting comment on expanding GST to e-commerce delivery of low value shipments. The policy framework is still evolving, but the basic argument is that e-commerce has created an uneven playing field for local companies in Singapore because foreign vendors do not have to pay the consumption GST tax. This harms local firms.

The proposal suggests a simplified registration system for firms selling more than SGD\$1 million in goods and services into Singapore in the B2C marketplace to pay GST. While this threshold suggests that small firms would be exempt from this

requirement, the proposal also indicates that online platforms or shipping agents will be required to register all firms using their services and collect GST on behalf of companies.

Clearly, this is where things get complicated, as platforms and agents are effectively asked to register potentially thousands or hundreds of thousands of foreign firms from around the globe and collect taxes from each of them if they sell items to Singaporean customers.

Conclusions

Australia's provisions to tax low-value imports related to e-commerce may be the first in the world, but the use and value of such a tax has been debated since the 1990s. That there have been very few governments implementing e-commerce tax laws is indicative of the multiple issues that arise from e-commerce taxation. Australia recently decided to postpone implementation of their tax policy for a year to study the matter further. The United States government has gone so far as to pass a permanent ban on e-commerce tax through the House floor.^{xxiii}

Other governments, such as Indonesian government, have also considered taxing offshore suppliers to level the playing field between domestic firms and overseas firms even though they are aware that they might not have sufficient capacity to monitor and enforce such a new tax system.^{xxiv}

For countries which have low de minimis threshold – below which exporters or importers don't have to pay for duty or tax – like Canada, the issue of taxing low-value imports could also be about the efficiency of such a system. According to a research done by C.D. Howe Institution in 2016, with a de minimis level at C\$20 instead of C\$80, the cost of collecting addition 39 million tax revenue is 166 million.^{xxv}

More and more, consumers are shopping online because of better prices and convenient transactions. However, taxation of e-commerce will raise the price of goods and services, making it less attractive to consumers. The loss of potential buyers could potentially harm the development of e-commerce and businesses that flourish with the



support of online infrastructures. Though governments seek to increase tax revenues and level the playing field between online and traditional business, the actual outcomes of e-commerce taxation are unlikely to match the government's original intent.

The damage done to smaller e-commerce and digital trade firms is likely to be significant. One of the biggest benefits of the online world is the ability of the companies to become a "micromultinational" and find consumers anywhere in the globe. If firms are now required to register in each jurisdiction where they might conceivably find a consumer and pay taxes even for low value shipments or for digital products and services, many of these small firms will be unable to compete at all.

The promise of e-commerce and digital trade could be lost.

ⁱ U.S. Department of Commerce – Census Bureau (2017, May 24). E-States 2015: Measuring the Electronic Economy – Economy-Wide Statistics Briefs. Link: <https://www.census.gov/content/dam/Census/library/publications/2017/econ/e15-estats.pdf> [Accessed on June 7th 2017]

ⁱⁱ OECD (2013), "Measuring the Internet Economy: A Contribution to the Research Agenda", *OECD Digital Economy Papers*, No. 226, OECD Publishing. <http://dx.doi.org/10.1787/5k43gjq6r8jf-en> Link: <https://www.digital.je/media/Secure-Strategic-Documents/OECD%20-%20Measuring%20the%20Internet%20Economy%20-%202013.pdf> [Accessed on June 7th 2017]

ⁱⁱⁱ OECD (2017, January 12). Key Issues for Digital transformation in the G20: Report prepared for a joint G20 German Presidency/OECD conference. Link: <https://www.oecd.org/g20/key-issues-for-digital-transformation-in-the-g20.pdf> [Accessed on June 7th 2017]

^{iv} Yang and Lauricella (2010) find that untaxed e-commerce was projected to incur a tax revenue loss of more than US\$12.65 billion in the U.S. Read more at: James G. S. Yang and Leonard J. Lauricella, (2010), "Tax Problems of Digitized e-Business." *Journal of Internet Commerce*, Vol. 9 no. 3-4, pp. 222-242, doi: 10.1080/15332861.2010.526490.

Nishiyama's 2014 study on Japan's consumption tax (JCT) suggests that, given estimates of sales figures for digital books, digital music, and digital advertisements, the Japanese government would lose about 25,000 million JPY per year due to non-taxation of digital services. Read more at: Yumi Nishiyama, (2014), "Latest changes to the Japanese consumption tax: rate increase and taxation of digital services." *World Journal of*

VAT/GST Law, Vol. 3, no. 2, pp. 108-114, doi: 10.5235/20488432.3.2.108.

^v David C. Chou (1999), "The Economics of Taxing Electronic Commerce." *Information Systems Management*, Vol. 16, no. 1, pp. 7-14, doi: 10.1201/1078/43187.16.1.19990101/31156.

^{vi} David C. Chou (1999), "The Economics of Taxing Electronic Commerce." *Information Systems Management*, Vol. 16, no. 1, pp. 7-14, doi: 10.1201/1078/43187.16.1.19990101/31156.; and Richard Cardinali, (2001), "Taxing the Internet: leveling the playing field or milking the cash cow?", *European Business Review*, Vol. 13 no. 6, pp.346-353, doi: 10.1108/EUM00000000006197.

^{vii} Catherine Pilkington and Sue Farron, (2000), "International direct taxation of e-commerce: Developing a new conceptual model from marketing principles.", *Journal of Applied Accounting Research*, Vol. 6 no. 1, pp.85-109, doi: 10.1108/96754260080001023; and Richard Cardinali, (2001), "Taxing the Internet: leveling the playing field or milking the cash cow?", *European Business Review*, Vol. 13 no. 6, pp.346-353, doi: 10.1108/EUM00000000006197.

^{viii} Richard Cardinali, (2001), "Taxing the Internet: leveling the playing field or milking the cash cow?", *European Business Review*, Vol. 13 no. 6, pp.346-353, doi: 10.1108/EUM00000000006197.

^{ix} Catherine Pilkington and Sue Farron, (2000), "International direct taxation of e-commerce: Developing a new conceptual model from marketing principles.", *Journal of Applied Accounting Research*, Vol. 6 no. 1, pp.85-109, doi: 10.1108/96754260080001023; and Richard Cardinali, (2001), "Taxing the Internet: leveling the playing field or milking the cash cow?", *European Business Review*, Vol. 13 no. 6, pp.346-353, doi: 10.1108/EUM00000000006197.

^x Richard Cardinali, (2001), "Taxing the Internet: leveling the playing field or milking the cash cow?", *European Business Review*, Vol. 13 no. 6, pp.346-353, doi: 10.1108/EUM00000000006197.

^{xi} David C. Chou (1999), "The Economics of Taxing Electronic Commerce." *Information Systems Management*, Vol. 16, no. 1, pp. 7-14, doi: 10.1201/1078/43187.16.1.19990101/31156; and

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^{xii} Bernadette Kamleitner, Christian Korunka, Erich Kirchler, (2012), "Tax compliance of small business owners: A review", *International Journal of Entrepreneurial Behavior*, vol. 18, no. 3, ppp. 330-351, doi: 10.1108/13552551211227710.

^{xiii} Parliament of Australia (2015, December 2). Statistical snapshot: small business contribution to economic performance in Australia. Link: http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1516/Perform [Accessed on June 1st 2017]

^{xiv} The Hon Michael McCormack MP, Minister for Small Business (2017, February 17). Levelling the playing field for Aussie small businesses online. Media Release. Link:



<http://mfmm.ministers.treasury.gov.au/media-release/015-2017/> [Accessed on February 17th 2017]

^{xv} EY (2017, February 27). Australia introduces legislation on GST on “low value” imports from 1 July 2017. Indirect Tax Alert. Link: <http://www.ey.com/gl/en/services/tax/international-tax/alert--australia-introduces-legislation-on-gst-on-low-value-imports-from-1-july-2017> [Accessed on June 2nd 2017]

^{xvi} According to article 84-77(4) under Australia’s Treasury Laws Amendment (GST Low Value Goods) Bill 2017, “Redeliverer” is the services provider that assists the delivery of the goods from offshore suppliers to Australian customers. These services include directly delivering the goods, procuring, arranging and facilitating the delivery, etc.

^{xvii} Australian Taxation Office (2017, May 5). International taxation of goods and services supplied to Australia. Link:

<https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Doing-business-in-Australia/International-taxation-of-goods-and-services-supplied-to-Australia/>; and Australian Taxation Office (2017, April 6). GST on low value imported goods. Link: <https://www.ato.gov.au/general/new-legislation/in-detail/indirect-taxes/gst/gst-on-low-value-imported-goods/> [Accessed on June 1st 2017]

^{xviii} Australian Taxation Office (2017, February 20). Services and digital products covered by the measure. Link: <https://www.ato.gov.au/Business/International-tax-for-business/In-detail/Doing-business-in-Australia/New-Australian-law-applying-GST-to-imported-digital-products-and-services/?anchor=Servicesanddigitalproductscoveredbytheme#Servicesanddigitalproductscoveredbytheme> [Accessed on June 1st 2017]

^{xix} EY Tax Insights (2014, July). E-services in South Africa. Link: <http://taxinsights.ey.com/archive/archive-articles/e-services-in-south-africa.aspx> [Accessed June 5th, 2017]

^{xx} Deloitte. JCT on Digital Services – New guidance issued. Link: <https://www2.deloitte.com/jp/en/pages/tax/articles/int/japan-inbound-tax-alert-june-2015-no13.html> and National Tax Agency – Japan (2015, May). Revision of Consumption Taxation on Cross-border Supplies of Services. Link: http://www.nta.go.jp/foreign_language/consumption_tax/cross-kokugai-en.pdf [Accessed on June 5th 2017].

^{xxi} Suchit Leesa-Nguansuk (2017, March 1). New tax on e-commerce due in April. Bangkok Post. Link: <http://www.bangkokpost.com/tech/local-news/1206721/new-tax-on-e-commerce-due-in-april> [Accessed on June 5th 2017]

^{xxii} Inland Revenue Authority of Singapore (IRAS). Specific business sectors: E-commerce. Link: <https://www.iras.gov.sg/irashome/GST/GST-registered-businesses/Specific-business-sectors/e-Commerce/#> [Accessed on June 5th 2017]

^{xxiii} United States Congress. H.R.235 – Permanent Internet Tax Freedom Act. Link: <https://www.congress.gov/bill/114th-congress/house-bill/235> [Accessed on June 5th 2017].

^{xxiv} PS Engage. Public Consultation Report: Taxation on E-commerce in Indonesia.

^{xxv} Christine McDaniel, Simon Schropp and Olim Latipov (2016, June 26). Rights of Passage: The Economic Effects of Raising the de minimis Threshold in Canada. *C.D. Howe Institute E-Brief*. Link: https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/E-brief_Rights%20of%20Passage_June16.pdf [Accessed on June 6th 2017]

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