



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION

TO THE COUNCIL, THE EUROPEAN PARLIAMENT
AND THE ECONOMIC AND SOCIAL COMMITTEE

**ELECTRONIC COMMERCE AND
INDIRECT TAXATION**

I. Background

In its Communication "A European Initiative in Electronic Commerce" COM(97)157 the Commission stressed the need to ensure a clear and neutral tax environment and the importance of implementing tax rules which avoid market distortion: "in order to allow electronic commerce to develop, it is vital for tax systems to provide legal certainty (so that tax obligations are clear, transparent and predictable) and tax neutrality (so that there is no extra burden on these new activities as compared to more traditional commerce)". It also stated that VAT, as opposed to any new form of tax, is appropriate to electronic commerce, just as it is to more traditional ways of conducting business.

Similarly, in the Joint EU-US Statement on Electronic Commerce (5 December 1997), it was also accepted that "taxes on electronic commerce should be clear, consistent, neutral and non discriminatory". In the Bonn Declaration signed by 29 countries on 6 July 1997, Ministers supported "the principle of non-discriminatory taxes on use of Global Information Networks" and stated that "tax issues of electronic commerce call for international co-operation and, where appropriate, co-ordination in order to avoid distortion of competition".

Additionally, in the multilateral area, the WTO has taken the decision to launch a comprehensive work programme on electronic commerce. The recommendations for action reached through this work programme will be submitted to the 1999 WTO Ministerial Conference. The Commission will play an active part in this work which will include consideration of the way in which indirect taxation should be applied to electronic transactions.

In this perspective the Commission's overall objective is to ensure that this new way of doing business can flourish in a tax environment with a minimum of burden. Where any legislative changes are necessary, these should neither advantage nor disadvantage electronic commerce compared with other forms of commerce. It is also fully appreciated that any future tax mechanism in this field will have to be designed in co-operation with all business interests and trading partners. This will involve taking full account of commercial practices within the new environment.

VAT is applicable to all supplies of goods and services for consumption within the EU regardless of the means of communication or commercial mode used to effect the transactions. The EU VAT system should therefore provide the *legal certainty*, *simplicity* and *neutrality* required for the full development of electronic commerce.

Legal certainty enables commerce to be conducted in an environment where the rules are clear and consistent reducing the risks of unforeseen tax liabilities and disputes.

Simplicity is necessary to keep the burdens of compliance to a minimum. In that respect the Commission continues to be fully committed to the introduction of the future common VAT system based on taxation at origin and providing for a single country of registration where an operator would both account for and deduct tax in respect of all his EU VAT transactions¹.

¹ COM(96)328 Final

Neutrality means that:

- the consequences of taxation should be the same for transactions in **goods** and **services**, regardless of the mode of commerce used or whether delivery is effected on-line or off-line.
- the consequences of taxation should be the same for services and goods whether they are purchased from **within** or from **outside the EU**

Certainty, simplicity and neutrality are all essential to ensure a level competitive playing field for all traders in the developing global market place, and to avoid market distortions.

II. Electronic commerce: opportunities and challenges

The rapid growth of the Internet and its development as a tool to facilitate commercial transactions is opening up considerable new opportunities for business and consumers in Europe. The Framework Communication "A European Initiative in Electronic Commerce" noted that "by its very nature, electronic commerce is transnational and encourages cross border ordering and delivery of goods and services in the Single Market, that it directly stimulated European growth and competitiveness, and that it represents "a potentially vital factor for cohesion and integration in Europe".

At the same time, however, electronic commerce is presenting new challenges not least in the field of indirect taxation. The new global markets that are emerging will no longer be constrained geographically. It will become potentially more difficult to know the location and identity of the parties to transactions. This will present tax authorities with challenges needing careful study in partnership with the business community. It will be essential that taxation be applied in a way that ensures that electronic commerce can flourish and realise its full potential to benefit the EU economy and promote higher levels of employment.

The Internet is rapidly evolving from primarily a communication tool to becoming a global trading platform. The business community is already aware of its potential use as a marketing and sales medium. At the moment, commercial use is mainly in the field of advertising and ordering of products. Other innovative uses are developing, in the area both of "indirect" electronic commerce (electronic ordering of tangible goods), and "direct" electronic commerce (electronic ordering and delivery of products and services on-line over the networks). Although the market remains small, in absolute terms, networks are expanding rapidly and becoming more sophisticated. With increasing transmission speeds and the development of secure means of payment, it is predicted that over the next few years the market will grow rapidly.

The supply within the EU of all goods and services is subject to tax under existing VAT provisions. This is also the case for importations of goods by businesses and individuals and for the purchase by businesses of most services from sources outside the EU. Until now the direct purchase of services by EU private individuals, being rare, is, for the most part, not currently subject to VAT. The latter type of transaction, which potentially poses the most thorny problems for tax administrations, is predicted to increase considerably as on-line delivery becomes quicker and more reliable. Even so, it is forecast that these are

unlikely to become significant in economic terms by the year 2001. While there is no immediate need for changes in the current tax provisions, it is nevertheless necessary to monitor the way in which these markets are evolving and to develop solutions in conjunction with the industry. Such solutions should simplify existing tax provisions, and be compatible with the essentially decentralised and international nature of the emerging electronic global markets.

III. The international dimension

The United States Treasury policy statements on e-commerce, made early in 1997, provided a stimulus for the current high profile debate on this new phenomenon. Since then the debate has widened to include many of our other trading partners in multilateral fora, such as the OECD and WTO. The Commission is actively contributing to all these activities, in particular in the crucial area of taxation. This includes, in particular, continuing wide-ranging consultations with representatives of businesses on tax issues both on its own initiative and together with the OECD. Taxation will, thus be one of the four key issues discussed at the OECD Ministerial Conference "A Borderless World: Realising the Potential of Electronic Commerce", which will take place in Ottawa on 6-8 October 1998.

IV. The objective of the communication

The purpose of this communication is to prepare the contribution by the EU and its Member States on indirect taxation issues for the Ottawa Conference. In this respect, this communication aims at defining guidelines for taxation on which to base any further debate of these issues with all interested parties - governments, industry, consumers - both in the Internal Market context, and internationally, in an effort to find global solutions. As a contribution to the forthcoming debate, it also allows the Council to consider the work that has been done so far by the Commission and the Member States in the tax field. It proposes a number of general guidelines which should steer further study of ways of adapting the EU VAT system in order to provide the clear and simple rules required to meet the needs and support the development of the emerging e-commerce in Europe.

This communication does not address directly the issue of the future changes to VAT in the Internal Market. The Commission is fully aware of the problems resulting from the current Community VAT system which are perceived by operators, and in particular by SMEs, as one of the main obstacle to the development of electronic commerce in the Internal Market. For that reason, the Commission continues to be committed to the introduction of a common VAT system based on taxation at origin and providing for a single country of registration where an operator would both account for and deduct tax in respect of all his EU VAT transactions.

V. Guidelines.

Guideline 1: No new taxes

The first guideline has been formulated to reflect the basic concept that existing taxes should apply to electronic commerce:

1. In the field of indirect taxation all efforts should be concentrated on adapting existing taxes and more specifically VAT to the developments of e-commerce. No new or additional taxes are therefore to be considered.

Guideline 2: Electronic transmissions as services

VAT is designed as a general consumption tax that, in principle, applies to all supplies of goods and services. In all cases *transactions taking place within the EU*, using the medium of electronic commerce and resulting in consumption within the EU, are subject to EU VAT under existing provisions. However, that is not always the case where *supplies from non-EU countries* are concerned. In the case of *goods* supplied from a non-EU country to an EU recipient, normal import procedures ensure that VAT is applied regardless of the means used to conduct the transaction. Similarly, certain descriptions of *services received by EU businesses* from non-EU countries are subject to VAT. However, it should be noted that with few exceptions, *services received by EU private persons* are not, under existing provisions, subject to VAT, (the volumes of such supplies is at present very small).

It is the policy of the EU to consider products ordered and delivered on networks to be services. E.U. VAT legislation makes a basic distinction between the supply of goods and the supply of services. All types of electronic transmissions and all intangible products delivered by such means are deemed, for the purposes of EU VAT, to be services. This is in keeping with the position taken by the EU and its Member States at WTO. In the tax area, this also allows for a clear set of rules to be applied.

2. A supply that results in a product being placed at the disposal of the recipient in digital form via an electronic network is to be treated for VAT purposes, as a supply of services.¹

Guideline 3: Ensuring neutrality

¹ Supplies of these electronically delivered products may also be delivered by more conventional means in a tangible form and, according to their characteristics, be treated for VAT purposes either as supplies of services or of goods. Those currently treated as goods, such as supplies of music or video on disc or cassette may be subject to customs duties at importation. Products that, in their tangible form are treated for VAT purposes as goods are treated as services when they are delivered by electronic means.

It has already been noted that rapid growth in all types of e-commerce is expected, resulting in an increase of supplies from non-EU countries to final consumers in the EU. Inevitably, this will include on-line supplies of "intangibles" such as music, video or software.

Turn-over relating to EU final consumption attributable to e-commerce (i.e. delivered to private individuals as opposed to companies) is difficult to estimate. This may reach a figure of 5bn ECU by the year 2001 for all types of electronic commerce – goods and services, ordered and paid for on-line, irrespective of mode of delivery.. Only a proportion of this total will be attributable to supplies from non-EU sources and only a further fraction of this will consist partly of of "direct" electronic commerce, i.e. services delivered on-line .

The latter representing services ordered by EU private consumers from suppliers outside the EU for delivery on-line are the activities, that present the greatest challenge in terms of collection of VAT. If the predicted increase in such services supplied to final consumers, who at present pay no VAT, reaches a level which is economically significant it may be necessary, in conjunction with the business community, to design mechanisms to tax such supplies.

The absence of such taxation would lead to unfair competition for EU operators who already have to tax their supplies of services for private consumption within the EU. Similarly, because many on-line services are currently subject to tax under EU rules at the place of origin, VAT is payable by EU suppliers on all the services they supply to non-EU countries. Conversely, supplies from non-EU countries to the EU would not be taxed – clearly a double competitive disadvantage for EU businesses. Such discrepancies in the application of tax clearly offend against the principle of neutrality.

In order to avoid this type of distortion and to assure the neutrality of the tax system it would be desirable that:

3. The E.U. VAT system should ensure that:

- *Services, whether supplied via e-commerce or otherwise, which are supplied for consumption within the E.U. are taxed within the E.U., whatever their origin.*
- *Such services, supplied by EU operators for consumption outside the E.U. are not subject to VAT in the E.U. and VAT on related inputs is eligible for deduction.*

The above guideline does not prejudge the rules that will be applied within the E.U.

However, since the practical implementation of this guideline will present problems, the Commission intends to pursue its reflections in consultation with member States, within a Working Group established by the Commission and with the business sector.

The last but one sentence reflects the Commission's continuing commitment to the introduction of a common VAT system based on taxation at origin and providing for a single country of registration where an operator would both account for and deduct tax in respect of all his EU VAT transactions. Such a system would not only simplify the operation of the tax system for EU businesses but would also provide non-EU businesses with the possibility of meeting their EU VAT obligations in a single country.

Overall, this guideline represents a significant change compared to the present situation. It would mean that all services delivered on-line from non-EU sources to private individuals in the EU would be subject to VAT and that all such services exported from the EU to other countries would be free of VAT. This would ensure tax neutrality between EU and non-EU supplies. To preserve tax neutrality between offline and online deliveries, it would mean that, unlike now, services delivered by traditional means, such as telephone, or fax, from non-EU sources to private individuals in the EU, would also be subjected to VAT.

Guideline 4: Making compliance easy

The credibility of any system of taxation rests on its practicality, and the feasibility of its implementation. There should be certainty about the rules and compliance should be made as simple as possible to avoid unnecessary burdens on business. Also there must be assurance, both from the point of view of the businesses concerned and the tax authorities, that the tax can be controlled and collected efficiently and effectively. The global nature of these commercial activities has to be taken into account and international consensus and co-operation should be sought to create the right tools to make compliance easy.

Tax mechanisms should be designed to be fully compatible, with commercial practices that are likely to change with the advent of e-commerce. Also they should be proportional taking account of the specific needs of internet businesses having regard to the fundamentally transnational, diversified and decentralised nature of the market. The alignment of the tax systems with established business practices is fundamental to the efficiency of tax accounting both for operators and tax authorities and in this respect the following formulations cater for the foreseeable need of the emerging e-commerce environment:

4. Compliance for all operators in the field of e-commerce should be made as easy and simple as possible.

Guideline 5: Ensuring Control and enforcement

As already stated the tax systems will have to ensure that all types of consumption in the EU will be taxed in the same way. Rules should be restricted to a minimum and disproportionate obligations avoided in order to allow e-commerce to flourish. However, at the same time, there must be assurances that the tax can be controlled in an effective way.

5. The tax system and its control tools must ensure that taxation is enforceable on supplies of services received within the E.U., via e-commerce, by both businesses and private individuals.

As regards individuals, mechanisms devised will have to conform to existing Community legislation as regards protection of personal data.

Guideline 6: Facilitating tax administration

If businesses are to have confidence in a tax system it must be capable of being applied fairly and with certainty and in a manner which allows the full benefits of e-commerce to be realised. It should be recognised that the EU and its Member States' own best interests lie in creating conditions that will facilitate non-E.U. operators in accounting for E.U. VAT on e-commerce.

By the same token, it is essential to ensure that, in the field of e-commerce, compliance burdens are no more onerous for EU operators than they are for non-EU operators. It will be essential in the new environment to ensure that invoicing and accounting by electronic means is made available.

6. Paperless electronic invoicing will be a characteristic of electronic commerce and must be authorised for VAT purposes for transactions within the E.U. The legitimate interest of Member States must however be safeguarded by the provision of sufficient tools for control and prevention of abuse when fixing the conditions for the use of electronic invoicing on a uniform basis within the E.U. Similarly, high priority should be given to creating a framework of co-operation between E.U. and other countries to ensure that conditions, equivalent to those provided within the E.U. are also created for international electronic invoicing.

7. Subject to uniform EC conditions, fiscal administrations should provide for operators, participating in e-commerce to discharge their fiscal obligations by means of electronic VAT declarations and accounting.

Here again, tax administrations will need to be active players in the electronic world, prepared to integrate its concepts and practices into their dealings with operators and consumers in the global electronic commerce environment.

VII. Conclusion

The foregoing guidelines are fully in tune with the aims and objective of the EU VAT system. However they also allow for the possibility of a neutral interface with the tax regimes of other non-EU countries insofar as they only provide for taxation of supplies consumed within the territory of the EU. Supplies from the EU to other countries would not be subject to EU tax and, as now, in the case of goods and most services, it would be

for them to decide whether they wished to apply indirect taxes of their own to those incoming supplies. This is of particular importance in the discussions that are due to take place at the OECD Ministerial conference with business in Ottawa in October concerning the establishment of a global tax framework.

The Commission therefore invites the Council to consider the aforementioned broad guidelines for EU indirect taxation of electronic commerce. These should form the basis of the EU's input in the forthcoming Ottawa Conference. They serve as a basis for further ongoing discussions within the EU and internationally with all concerned with development and participation in E-commerce. At this stage, where e-commerce technology is still developing and patterns of trade are as yet unclear it is not necessary or possible to change the existing scheme of tax. However, broad guidelines are needed to steer the direction of the on-going debate and to guide, in consultation with the business sector, future developments in the tax field in this new and rapidly growing global marketplace. The Commission is convinced that taxation consistent with these guidelines will contribute to the success of e-commerce and the EU economy by providing EU businesses with a level playing field for competition. The Commission's overall objective is to ensure that Electronic Commerce can flourish in a tax environment with a minimum of burden.

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