

# Molinari Legal Consultancy

UNITED ARAB EMIRATES



## LEGAL ASPECTS OF E-COMMERCE

TAX and the INTERNET

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### TAX and the INTERNET

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The revolutionary practice of e-commerce introduced an innovative way to conduct sales transactions via Internet thus increasing the availability a new range of products and services worldwide in the so-called global market<sup>1</sup>. Other important consequences of the e-commerce can be identified in the simplification of the commercial transactions that no longer require the use of traditional intermediaries and the increased difficulty for Government and tax authorities in detecting the commercial flow of intangible products and services<sup>2</sup>.

The idea of introducing an innovative tax on the Internet Communication and Information flows may be conducted to the 1996 Interim Report<sup>3</sup> presented by the Advocate Luc Soete<sup>4</sup>. This Report initially presented as a simple search, contained the revised<sup>5</sup> the idea that this innovative alternative tax solution could be assessed on the sheer volume of digital bits transmitted so called the Bit Tax<sup>6</sup>.

The concept of taxing the Internet transfers flow, however, appears to be full of ideological and social implications rather than being practical in its implementation<sup>7</sup>. Positive and negative aspects of taxing intangible goods sold via Internet have attracted a number of different reactions and opinions<sup>8</sup>. Moreover, several American States and some European Countries have already come up with new proposals for new Internet taxes have proved to be difficult to be unenforceable. New problems such as the identification of parties involved in the transactions, the applicable jurisdiction of tax liabilities, the risk of double taxation and enforcement of tax laws have prompted the attention of legislators and analysts around the world.

The idea of Bit Tax is of natural interest of Governments since they consider that the information generated through the system and the global network create an added value<sup>9</sup> to be taxed, as many nations registered a substantial loss in their sales tax revenue in connection with the grow of the sales via Internet, which benefits only the final consumers and the manufacturers/suppliers<sup>10</sup>. This situation may be made even worse if comforted by a significant progressive reduction of intermediaries such as banks, credit card or other financial institutions which are very critical to tax authorities to detect and report financial transactions<sup>11</sup>.

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- 1 Taxation aspects of Electronic Commerce - Public release of OECD Reports (June 2000).
  - 2 Catherine Colston, November 2000, E-Commerce Seminar, Strathclyde University.
  - 3 European Commission High Level Expert Group on the Social and Societal Commission Aspects of the Information Society led by adv. Soete.
  - 4 Soete and Ter Weel (1998).
  - 5 Idea originally formulated in 1994 by J. Cordell and Thomas Idle and presented at the Club of Rome.
  - 6 The European Commission, invested in evaluating this proposes of alternative taxation in the new economy, formally rejected the idea of a Bit Tax as considered it inappropriate.
  - 7 Multi-jurisdictional taxation of electronic commerce. The international Tax Program and the society for Law and Tax Policy Harvard Law School, 5th April, 1997. Jeanne Goulet, Director for Taxes for IBM credit Corporation (914) 642-4188.
  - 8 States Argue for taxing Internet transaction since the 1999 Internet tax Freedom Act
  - 9 Reaction to European Commission, DG XIII, Bit Tax Proposal Analysis, Luc Soete.
  - 10 Tanouye, E. <Government say Internet Taxes are essential>, Hearst Newspaper 1997.
  - 11 Ganguly R., <Taxation of Cyberspace Transactions: Working Towards Solutions' > April 1997.

Among the positive aspects of urging the taxation on the electronic transmissions it has been argued that Governments usually adjust and modernize their existing tax and policy systems (sometimes dated twenty years back) in adherence with the changes of the new economy and adopt new regulations which can allow them to exercise more control and generate more tax revenue<sup>12</sup>.

The natural consequence will be that what applies for communication services and equipment should be levied also on the communication activities on Internet since today a clear distinction between information transmission and information provision is not any more possible due to the rapid convergence of the two forms of technology<sup>13</sup>. Therefore, if an indirect tax, such as VAT<sup>14</sup>, is applied on telephone calls the Bit Tax should apply also to Internet. Ideal new tax collector intermediaries could be the telecommunication operators or Internet Service Providers (ISPs) on those goods and services ordered via Internet<sup>15</sup>.

Another point raised in favor of the Bit Tax suggests that it could reduce the use of Internet by workers and employees that would see the prospect of receiving their salaries deducted by applied bit taxes. The de-congestion on the Internet could be the natural consequence of imposing tax over Internet and in some extent could help in creating a more efficient and accurate use of the electronic information reducing the so called information pollution<sup>16</sup>.

One of the main critics against the Bit Tax is that the taxation should induce economic behavior to society or at least not to discourage it, while the only aim, which seems to have sustained the proposed Internet taxes appears to be the rise of funds for the Government<sup>17</sup>.

In another negative consideration it has been observed that if the communications activities on the Internet would be taxed in the same way of the communications services and equipments, then the Bit Tax would lead to double taxation. In this way the tax would be paid twice when the necessary equipment is purchased and when the phone call is made.<sup>18</sup> Besides, it could be also argued that if we do not pay tax for other traditional ways of information transfer as for example a fax there should be no reasons in taxing Internet.

The fact that the Bit Tax would levy taxes according to an added value of bits and not to the real economic value of the good could create an enormous loss of economy efficiency since the price would be reviewed and fixed by social planners. Therefore, we would face the situation where a simple video clip with no value could be taxed in the same way as a database with substantial value.

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12 <http://meritbbs.unimaas.nl/cybertax/aspects.html>. Taxing Cyberspace.

13 <http://meritbbs.unimaas.nl/cybertax/arguments.html> The Argument for Taxing Cyberspace.

14 VAT- Indirect tax based on the principle that the more that you consume the more you ought to pay.

15 Van Aelst,L., "Taxing cyberspace", Information Strategy", June 1997.

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17 <http://arraydev.com/commerce/jibc/9703-06.htm> A Focus on Internet Commerce Taxation. Mauro Chiappone.

18 Euro Bit Tax? Yes, I am afraid it is true. Oppose to Euro Bit Tax.

The Bit Tax would not solve the particular taxation raised by electronic transactions since it could be difficult to trace the transactions and their relevant jurisdictions if companies start building and adopting technologies, which can hide the commercial transactions in order to avoid Internet taxes. A tax on a non-physical transaction is extremely difficult to implement. Bits are difficult to count and could be hidden by encryption. The Bit Tax could create incentives for tax avoidance through, for example, compressing data or keeping it in analog form. It has been noted that sometimes some online goods and services such as browsing through a virtual bookstore, are not priced at all and therefore a tax on such goods and services, if applicable, seem to be unfair.

Finally the creation of a new tax system capable of monitoring all commercial transaction on Internet, which foresees a proper new complex accounting system, requires an enormous economic effort, risks to be totally inappropriate with no economic justification. Moreover, this ambitious project if not implemented on a worldwide scale<sup>19</sup> could lead to distortion in competitiveness where an on line transaction may be simply transferred to a safer tax-free country.

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<sup>19</sup> The concept of Bit Taxes should be introduced on worldwide basis and related not to the actual value of the goods or services of the transaction but on the transmission of the Internet.