

Taxing E-Commerce Transactions: A Global Perspective

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Abstract

The study discusses the important concepts woven around the idea of e tailing and taxation policy measures and aims at coming up with a conclusion which will help further to determine the appropriate tax policies for e retailers keeping in mind the global framework. The study aims at discussing the concept of Internet Taxation, E-Retailing laws and regulations in Global Context. The study also discusses broad outlines relating to taxability of E-Retailing transactions from VAT and CST angle under different scenarios and arguments in favor and against of taxing the e tailing transactions. The study also discusses important acts passed in different economies for taxing online retailers including Marketplace Fairness Act 2013 (Passed in USA to make it easier for states to collect web sales taxes) and Internet Tax Freedom Act. It is concluded by discussing the possible effects of the online retail tax. The task of taxing commerce on the Net is daunting, since the data flowing through the vast annals of the Internet is intangible and the network on which it is built is spread over. Despite the divergence of method between traditional commercial transaction and e commerce transactions. It is essential to conform to the neutrality of taxation. As techniques of e-commerce progress, the situations become more complex.

Keywords: E-retailing, Global Taxation Policy, Internet Taxation, Online Retail Tax

1. Introduction

The rise of e-commerce is posing various questions for taxation policy and administration. E-commerce makes easier for business to be conducted without creating the “permanent establishment” that would otherwise subject a seller to tax on income. It diminishes the distinctions between the sale of goods, the provision of services and the licensing of intangible assets, each of which is subject to some form of taxation. Rapid developments in information technology have not only had an impact on assessing tax liability and collecting revenue, but on the State’s ability to identify the growing number of taxable transactions that take place in cyberspace. Globalization has enabled large multinational corporations’ growth faster than some nations in terms of gross domestic product. By using their large information bases international media conglomerates are able to shape world opinion on

most subjects. With workforces that can exceed some nations’ populations, international business is able to impose a significant influence on international trade and commerce, mostly to enhance profits. Consequently their powers to employ innovative tax saving devices cause the State to lose revenue. IT has exacerbated this by placing international business in a better position to manipulate their accounts worldwide, and to wield greater negotiating power with the State on the taxability of their transactions. But a state’s rights to impose taxation must be protected if it is to survive.

2. Literature Review

Alison Shelton, an economic researcher from the American Association of Retired Persons Public Policy Institute, argues that sales tax provides about 25 percent, on average, of state and local tax revenues. These taxes go

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uncollected on many Internet sales. This is because the Supreme Court has placed limits on the states' abilities to require certain out-of-state merchants to collect the tax. Moreover, consumers have failed to carry out their legal responsibilities to submit the sales tax to their home states. Thus under the existing laws related to sales tax, identical products may be taxed differently depending on whether they are purchased over the Internet, through a catalogue, or in a traditional "mortar-and-bricks" store. Traditional retailers accuse that this situation confers a price advantage on catalogue and Internet retailers¹⁰.

Many states rely on sales tax revenue and are afraid that with the growth of Internet Commerce, they stand to lose billions of dollars in revenue on the state and local level. In a recent Congressional Research Service (CRS) Report for Congress, the U.S. Supreme Court sees the enforcing and collection of taxes by state and local governments as too much of a burden, not worth the bother. "Based on CRS calculations of state and local sales tax revenue as a portion of total tax revenue, Washington, Tennessee and Arizona are the states and local jurisdictions most reliant on the sales tax. In those states over 40% of total tax revenue is derived from the sales tax."⁹

Former congressman Jack Kemp in an article, Cal-Tax Digest states that he believes the "Internet is a driving force in the American and World economies. The current federal tax code is a confusing and corrupting burden on our economy. Certain factions are seeking to impose a new national framework of Internet taxation that may contain the same flaws as the current federal code and that may be unconstitutional."¹¹

Li³ provides a technical and policy analysis of the Canadian Goods and Services Tax (GST) in the context of e-commerce and suggests some options for reform. Even though the GST has had a bad reputation in Canada and its integrity is now threatened by growing online cross-border shopping, based on the revenue potential of the GST, a re-placement is highly unlikely, and a cleaned-up or reformed GST is more practical. Thus the government should take advantage of the opportunity presented by e-commerce to reform the GST.

In an application of the substance over form doctrine to the international e-commerce taxation issue, Ngoy⁶ proposes an approach consisting of applying what is called here the Permanent Establishment (PE) function test to e-commerce infrastructures in order to see whether they qualify for being fiscally treated as PE, if they pass the concerned test. The study concludes that some of them

substantially have the same function as the category of office PE, and they should be fiscally treated as this category of PE no matter the form they have.

The study aims at the following objectives:

- Understanding E-Taxation/Internet Taxation.
- Broad outlines relating to taxability of E-Retailing transactions from VAT and CST angle under different scenarios.
- Global taxation policy for e retailers.
- Arguments in favor and against of taxing the e tailing transactions.
- Possible effects of the online retail tax.

3. Internet Taxation

Since from the penetration of use of Internet in the late 90s, it was free from all regulations(especially tax levies, duties, imposts or license fees etc.) by respective governments but in 1996, countries start thinking the use of Internet services as a potential source of tax revenue and to look into the same, United States in the year 1998 came with "Internet Tax Freedom Act" to intervene the policy of taxation on use of internet services, however did not affect sales taxes applied to online purchases. The Internet Tax Freedom Act merely precludes the states in United States from imposing their sales tax, or any other kind of gross receipts tax, on certain online services. Internet tax system should be:

3.1 Equitable

Taxpayers in similar situations who carry out similar transactions should be taxed in the same way.

3.2 Simple

Administrative costs for the tax authorities and compliances costs for tax payers should be minimized as far as possible.

3.3 Certain

Certainty for the taxpayer is required so that the tax consequences of a transaction are known in advance.

3.4 Effective

It should produce the right amount of tax at the right time and minimize the potential for tax evasion and avoidance.

3.5 Flexible

The system should be sufficiently flexible and dynamic to ensure that tax rules keep pace with technological and commercial developments.

Any tax arrangements adopted domestically and any changes to existing international taxation principles should be structured to ensure a fair sharing of the Internet tax base among countries, particularly important as regards division of the tax base between developed and developing countries.

4. Taxation of E-Commerce Transactions

In absence of national boundaries and physical nature of transacting in goods/services (as is the case with traditional commerce), taxation of e-commerce activities raises several issues. With the accessibility to internet across borders, e-commerce transactions can involve people who are resident of more than one country. Therefore, income arising out of such transactions may be taxed in more than one country. The policies framed by the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development (“OECD”) highlighted neutrality; efficiency; certainty and simplicity; effectiveness and fairness; and flexibility as guiding principles for the taxation of e-commerce transactions.⁷³ In India, the High Powered Committee (“HPC”) constituted by the Central Board of Direct Taxes, submitted its report in September 2001. The report considered and contemplated upon the need for introducing a separate tax regime for e-commerce transactions. The report prepared by the HPC took into account the principles laid down by the OECD albeit with some exemptions. However, based on the principle of ‘neutrality’⁷⁵, the HPC maintained that the existing laws are sufficient to tax e-commerce transactions⁷⁶ and no separate regime for the taxation of e-commerce transactions is required. Indian tax authorities have been seeking to tax e-commerce and internet-based business models in a manner that conflict with international approaches. Global enterprises catering to Indian customers have faced difficulties as a consequence and there has been significant litigation in this respect, especially in relation to characterization of income and withholding taxes. Therefore, it becomes important to carefully structure e-commerce business models so as to mitigate tax risks, especially risk of

taxation in more than one country. Indian tax authorities have been seeking to tax e-commerce and internet-based business models in a manner that conflict with international approaches. Global enterprises catering to Indian customers have faced difficulties as a consequence and there has been significant litigation in this respect, especially in relation to characterization of income and withholding taxes. Therefore, it becomes important to carefully structure e-commerce business models so as to mitigate tax risks, especially risk of taxation in more than one country (without availability of credit for payment of taxes in countries other than the country of tax residence).

4.1 Broad Outlines Relating to Taxability of E-Retailing Transactions from VAT and CST Angle under Different Scenarios in India

E-Retailing transactions are growing by leaps and bounds, day by day, because of convenience, choice, cost competitiveness and transparency being offered. Recently, VAT departments in the States of Karnataka and Telangana (India) have raised the issue of taxability of E-Retailing transactions and doubts about evasion of tax. It is apprehended that E-Retailing firms may be forced to leave the Country unless and until clear and transparent guidelines are issued in this direction, without any arbitrariness and possibility for different interpretations which will lead to painful, costly and time consuming litigation. Leading E-Commerce giant Amazon has already indicated that they may leave the State of Karnataka or even Country, if the tax related arbitrariness hits their operations. This would result in loss of jobs, affect growth of the economy and add to impression in the minds of international community that the tax practices in India are not stable and do not allow them to carry out the business in a predictable manner. Therefore, it is the need of the hour for the State Governments to come out with clear cut and transparent guidelines on E-Retailing transactions.

Basically, E-Retailers can carry out three types of transactions:

(a) **Where the E-Retailers acts only as a facilitator**, in which he does not own any materials on his own, but allows the buyers to purchase the materials through his web site, in terms of the agreement between E-Retailers and the Seller who owns the materials. In this case, E-Retailer is purely a commission agent and out of the purview of the VAT or CST Acts. The liability towards VAT or CST in such a case would be as under:

- The taxability to either VAT or CST, depends upon the materials movement by seller, as he is required to deliver the materials to the buyer. In case the seller is required to make delivery of the goods to the buyer situated in the other State, consequent to the order placed by the buyer on the website of E-Retailers, then the seller is required to remit CST on the sale price of goods to the VAT department of the State from where the materials are moved. For eg, the seller is in the state of Maharashtra and buyer is in the state of Kerala. Then the materials are required to be transferred from Maharashtra to Kerala consequent to sale transaction carried out by the buyers on the E-Retailer's website. The seller in the state of Maharashtra is required to remit CST to the VAT department of Maharashtra State.
 - Alternatively, if the seller and buyers are both in the state of Maharashtra, then the material movement will be within the State of Maharashtra and the seller is required to remit VAT to the State of Maharashtra. No liability arises on the E-Retailers, as he does not own the materials and therefore not transferring any property in goods to the buyer.
- i. Material movement decides the nature of levy-If it is interstate movement, the seller is required to remit CST. In case of intra-state movement, the seller is required to remit VAT. The right to levy VAT or CST accrues to the State wherein the materials are moved.

(b) Where the E-Retailer purchases the materials on his own and then re-sells to the buyers, then the liability would be on the E-Retailers for discharge of VAT or CST as the case may be, which is explained hereunder:

- In case the material movement is within the same state, then the E-Retailer is required to remit VAT on the sale transaction to the VAT department of the State where the materials are located. For e.g. If the buyer is in the State of Kerala and places order on the website of the E-Retailer and if the E-Retailer holds the materials in his godown in the State of Kerala and makes delivery to the buyer, then the E-Retailer is required to remit VAT to Kerala.
- In case the material movement is from one state to another state, then the E-Retailer is required to remit CST to the state from where the material movement is initiated on account of sale transaction. For e.g. A buyer in Kerala places order on website of E-Retailer.

Consequently, the E Retailer who holds stock of the materials in the State of Karnataka is required to make delivery of the goods to the buyer in the State of Kerala. Since interstate movement is involved, the seller is required to remit CST to the state of Karnataka.

- The crux of the issue is - liability for VAT or CST arises in the State from where the materials are delivered. If the E-Retailer holds his materials in the state of Karnataka, then whether the buyer is in the State of Karnataka or Kerala, the liability to discharge VAT or CST on the part of E-Retailer accrues to the State of Karnataka.
- However, if the E-Retailer holds materials in the State of Kerala also, and delivers the materials to the buyer in the State of Kerala, then the liability arises in the State of Kerala and E-Retailer is required to remit VAT to the State of Kerala. Even though the web site related infrastructure of the E-Retailer is located in the State of Karnataka, no liability arises in the state of Karnataka, as there is no material movement from the State of Kerala.

(c) Third alternative is-Where the E-Retailer holds the materials of the Seller as an agent in his custody. In such a case, the E-Retailer is an agent of the seller and discharges the liability on behalf of the seller. Here again, the material movement determines the taxability of the transaction to VAT or CST.

- The E-Retailer holds the materials of the seller in his godown in Karnataka. Then he would be required to move the materials either to other States or within the State of Karnataka, based on the location of the buyer.
- If the buyer is located in the State of Karnataka, then the material movement will be within the State of Karnataka and E-Retailer is required to remit VAT to the state of Karnataka, on behalf of the seller.
- If the buyer is located in the state of Kerala, then the material movement is to be done from the State of Karnataka to Kerala, which becomes a CST sale and E-Retailer is required to remit CST to the State of Karnataka, on behalf of the Seller.
- The basic issue that is to be understood in the subject is - State where the materials are lying and from where the movement is initiated for delivery to the buyer, whether inter state or intra-state is competent to levy VAT or CST, depending upon the movement. Location of E-Retailer in a state does not automati-

cally casts obligation on him or empower the State to levy VAT or CAT, if the material is lying in other State and movement on account of sale is from that of other state.

- If the State VAT authorities are under the impression that location of E-Retailer in their casts liability on him, irrespective of the location of the materials and their movement, guidelines or instruction under such impression would result in disputes which would consume lot of time, energy and money of the E-Retailers.

4.2 Taxing Internet Sales under the Current US System

Sales tax is implemented at the state and local levels of governments in the United States. Currently, forty five states charge sales taxes on various types of retail sales. Of these states, thirty three of them authorize local governments to collect various forms of sales tax. The combination of state and local sales tax regulations results in more than 7500 taxing jurisdictions imposing some form of sales tax in the US. Citizens are technically supposed to pay tax on all internet purchases under current US law. However, unless the retailer is required to collect this tax due to nexus, individuals are supposed to self report and pay the tax themselves. Most consumers do not self report tax on their internet purchases. Consumers can easily avoid reporting this because the states do not pursue collecting the tax due to how cost effective it would be. For most purchasers, this is considered one of the benefits of purchasing items online. The tax that US citizens are supposed to pay and report on their internet purchases from retailers that do not collect sales tax is called an equivalent use tax. By definition, a use tax is a tax imposed on the use of certain goods that are bought outside the taxing authority's jurisdiction.

The substantial nexus requirement can lead to several inequalities. It puts brick and mortar and click and order retailers at 5-10 % worth of sales tax that brick companies must charge may not seem like a lot, but when inherently narrow profit margins in the retail industry are taken into account, it is plain to see why local "brick" businesses struggle to compete against internet retailers. Another argument raised in opposition to the "click only advantage" is that the internet retailers use state funded resources to assist them in commerce while at the same time do not collect sales tax that would be used to fund those resources. Some examples of the resources used by internet retailers are the construction and maintenance

of roads, state consumer protection agencies, and police and fire protection. The loophole also disproportionately affects lower income households as research shows that low income consumers are less likely to shop online than more affluent consumers.

There are also several common arguments against the implementation of a system that collects tax on all internet sales. Most of these arguments have to do with cost and complexity. Those in opposition to the tax claim that it would impose significant administrative costs on businesses by requiring them to abide by the laws of each state they have a purchaser in.

5. Conclusion

The legal system has constantly tried to catch up especially with the enactment of the various rules under the IT Act to deal with a host of issues emerging from the use of internet. Moreover the IP issues in e-commerce transactions have taken a new form with users finding loop holes to not only easily duplicate material but also mislead other users. Hence, much more is needed to effectively regulate the tangled web. Therefore an in-depth understanding of the legal regime and the possible issues that an e-commerce business would face coupled with effective risk management strategies has been the need of the hour for e-commerce businesses to thrive in this industry.

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