

# Summary of the Thesis:

## *Cross-Border Consumption Taxation of Digital Supplies* *A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce*

### I The Subject

Consumer X resident in Sweden but currently on vacation in Canada downloads a standard contract from a Canadian webpage. Consumer Y resident in Australia downloads music files from a British webpage. Consumer Z resident in Canada uses an IP-telephone phoning a friend in Australia; later on she watches a soccer game streamed to her computer. In order to decide where these transactions should be consumption taxed it is vital to establish where these three consumers usually reside, and from which state these services are supplied. Furthermore, the classification of these supplies affects whether they are considered as taxable transactions and, if so, the applicable tax rate. The consumers' place of residence and the place where the supplier has established her business is, however, less important for access to the different supplies considering that they can be obtained and supplied from a distance. The access to the services is instead limited by the technical equipment used by the consumer and the supplier as well as available networks.

The Internet and other techniques of distance communication have made it possible for both large multinational enterprises (MNEs) and small and medium sized companies (SMEs) to reach business partners and potential customers all over the world.<sup>1</sup> Different forms of electronic commerce (e-commerce) or mobile commerce (m-commerce) have opened up possibilities not only for new ways of doing business but for selling new types of products and services.<sup>2</sup> It has also become possible to deliver many of these products or services in a digital form; these forms of supplies are often called digitised goods or digital supplies. Several states commonly tax consumption of goods and services through some form of a national consumption tax system.<sup>3</sup>

Neither e-commerce nor consumption taxation are new phenomena. The Internet opened up the possibility of conducting e-commerce in the middle of the 20<sup>th</sup> century and theories of consumption taxation systems in different forms of value added taxes have existed since the beginning of the 20<sup>th</sup> century.<sup>4</sup> The intention of consumption taxation is to tax expenditures made by persons for private purposes, *i.e.* the tax burden is carried by the final consumer. Consumption taxes are an important revenue source for states. In 2005, 31.9 per cent of the revenue shares in the Organisation for Economic Co-operation and Development (OECD) Member States derived from consumption taxes and of which value added taxes and sales taxes accounted for 18.9 per cent.<sup>5</sup>

Many problems arise when the rapid evolution of techniques related to e-commerce is mixed with the objective of consumption taxation. One issue is that the traditional classification of supplies into either supplies of goods or supplies of services for the purposes of the European Community Value Added Tax framework (EC VAT) is challenged by supplies delivered in a digital form.<sup>6</sup> The buyer downloads the purchased material directly via her computer equipment or mobile telephone or receives it by other digital

<sup>1</sup> For a background on the development of Internet see *e.g.*, Roose, Eric N, "Global Taxation of Electronic Commerce", 4 *Asia-Pacific Tax Bulletin* 7 (1998), pp. 248-259.

<sup>2</sup> *E-commerce* and *m-commerce* are further discussed in Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008) section 1.5.2.

<sup>3</sup> Of OECDs 30 member states it is only the United States that does not have a form of value added tax, instead it uses a sales tax, see *e.g.* OECD, *Consumption Tax Trends, VAT/GST and Excise Rates, Trends and Administration Issues* (Paris: OECD, 2006) pp. 7 and 29.

<sup>4</sup> See Siemens, Carl Friedrich, *Veredelte Umsatzsteuer* first published 1919 by Siemenstadt and Adams, T.S., "Fundamental Problems of Federal Income Taxation" 35 *Quarterly Journal of Economics* 4, August 1921, pp. 527-556.

<sup>5</sup> See OECD "Consumption Taxes: the Way or the Future?" Policy Brief October 2007, p. 2.

<sup>6</sup> Other types of traditional supplies are supplies of property, often divided into real property, tangible and intangible property and services, which is further discussed in part two of this study. For an earlier discussion about the consequences of e-commerce for VAT see *e.g.* Baron, Richard "E-Commerce and Consumption Taxes", 3 *Tax Planning International e-commerce* 11 (2001), pp. 3-14 and Alhager, Eleonor, Eliasson, Christian, "Några synpunkter på Internet och mervärdesskatt" 51 *Skattenytt* 1-2 (2001), pp. 19-33.

means. Which consumption tax consequences do the difficulties in classifying digital supplies as goods or services lead to? Does the legal framework lead to a rational consumption taxation of these supplies?

On a national market, where the digital supply does not cross a territorial border of a state, the classification of digital supplies primarily affects the applicable tax rate and if it is exempted from taxation or is taxable. The classification of a supply also affects situations where suppliers and customers are located in different states and cross-border aspects of the digital supplies can be identified. Differing classifications in the state where the supplier is established and the state where the supply is consumed, or where the purchaser resides, may lead to double taxation or unintentional non-taxation.<sup>7</sup>

The Internet is a means for delivering digital supplies and it does not recognise geographical borders, but rather technical limitations. Yet tax legislation is based on the principle of territory, where sovereign states have the right to decide upon applicable legislation and which principles that shall determine if a supply is made within the territory or not. How can the cross-border transactions of digital supplies fit into the territorial tax systems? Do transactions have to fit into an existing legal framework or are new taxes needed? Are there cases of double taxation or unintentional non-taxation, and which are the causes for double taxation and unintentional non-taxation? When answering these questions risks of distortions in competition and the effects on fundamental principles of the applicable consumption tax system such as neutrality, efficiency and effectiveness, need to be considered.

International organisations<sup>8</sup> and EU institutions have pointed out that e-commerce and especially the legal framework regulating e-commerce should evolve equally throughout the world to avoid distortions in competition.<sup>9</sup> Hence, the cross-border aspects of digital supplies and consumption taxation thereof are important to consider and analyse. In doing so, the existing legislation could be clarified and the consumption taxation of cross-border transactions could be evaluated from a principal view of international co-ordination. The lack of international co-ordination could pose a hindrance to globalisation and lead to a reverse globalisation where markets become regional rather than global, *i.e.* a *post-globalisation*. The OECD is one organisation working with these issues, which in itself raises interesting legal issues. What role does the OECD have and what effects do its guidelines and policies have on legislators, tax authorities and courts, if any? What effects do the OECD guidelines and policies have for tax payers and consumers?<sup>10</sup>

The issues described above are crucial for the development of e-commerce, not least for the commerce between businesses and consumers (B2C), mainly due to the fact that consumers are directly affected by consumption taxes like VAT, since they carry the burden of the tax. It is also difficult to impose tax liability on final consumers because of this. The consumption tax rate affects the suppliers and their possibilities to compete with prices since the consumer price includes the applicable tax rate. The supplying companies also carry the administrative burden of being liable to tax.

The need for clarification of cross-border consumption taxation, in general and for e-commerce specifically, is justified by an increase in cross-border supplies. Society and industry develop new means of communication and trade and strains on tax systems of today are likely to increase in the future. For income taxation purposes, international models such as the OECD Model Tax Convention<sup>11</sup> create a common understanding of basic concepts.<sup>12</sup> Similar instruments do not exist for consumption taxation purposes. As described by *Westberg*

*“...the taxation of consumption is far more national or at least is limited to a single market like that in the EU or US”.*<sup>13</sup>

Perhaps a model tax convention for consumption tax purposes is needed?

<sup>7</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.5.

<sup>8</sup> Such as the OECD and the WTO.

<sup>9</sup> See *e.g.* Electronic Commerce: Taxation Framework Conditions. A Report by the Committee on Fiscal Affairs as presented to Ministers at the OECD Ministerial Conference, “A Borderless World: Realising the Potential of Electronic Commerce”, 8 October, 1998, p. 3, Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (‘Directive on electronic commerce’), OJ L178, 17.7.2000 preamble, para. 59, and WTO, Special studies 2, Electronic commerce and the role of WTO, (1998), p. 69.

<sup>10</sup> The use of OECD materials is further discussed in section 2.5.

<sup>11</sup> OECD, Model Tax Convention on Income and on Capital (2008).

<sup>12</sup> For an interesting discussion on the challenges in taxing e-commerce related to changes in society, principles and concepts, see also Hinnekens, Luc, “New Age International Taxation in the Digital Economy of the Global Society”, 25 *Intertax* 4 (1997), pp. 116-119.

<sup>13</sup> See Westberg, Björn, *Cross-Border Taxation of E-Commerce* (Amsterdam: IBFD Publications BV, 2002) p. 12.

The European Union (EU) is a good example of where the tax base is harmonised by EC legislation directly applicable in or affecting the national legislation of all Member States. The Court of Justice of the European Communities (ECJ) has a strong impact through its case law on how EC law should be interpreted.<sup>14</sup> Even so, the tax is collected and administered by the national authorities in the Member States and their courts rule on the tax consequences for those who are liable to pay tax. EC VAT is therefore not a common European tax in the sense of being collected and administered by an EU institution. Difficulties on the internal market of the EU and a uniform application of EC VAT in the different Member States exists. These differences do not depend on if a harmonised tax base exists or not, but on the effects of the harmonisation at a national level. Furthermore, these differences further enhance the challenges of taxing cross-border supplies.<sup>15</sup> A need for an international model or international consensus does not have to imply disadvantages to or negative effects on the ability to control consumption taxation at a national level. Instead the advantages of clarification and avoiding double taxation or unintentional non taxation of international transactions may be upheld on the internal market within the EU as well as from a global perspective.

## 2 Aim of the Study

The aim of this study is to *evaluate if the cross-border consumption taxation of digital supplies is rational from an international co-ordination perspective*.<sup>16</sup> The aim specifically covers a comparative study of double taxation and unintentional non-taxation in B2C e-commerce. Double taxation refers to taxation of the same transaction in more than one state.<sup>17</sup> Unintentional non-taxation refers to cross-border transactions not taxed in any jurisdiction. Such cases may exist where the criteria used for deciding the place of supply are interpreted and applied differently or do not correspond.<sup>18</sup> The comparative study covers EC VAT, Australian GST and Canadian GST.

Rationality, as used in this study, refers to if consumption taxation upholds the internationally agreed upon principles which are part of the Ottawa Taxation Framework Conditions<sup>19</sup> (the Framework Conditions). The evaluation of rationality is carried out through the use of an evaluation model, for which the Framework conditions provides a basis. The principles which are part of the Framework Conditions are; *neutrality, efficiency, certainty and simplicity, effectiveness and fairness and flexibility*. These principles are set in relation to Australian and Canadian GST and EC VAT before they are used as evaluation tools. In doing so different interpretations or scope of these principles can be identified in the compared jurisdictions.

Three main research questions can be specified within the aim. The first and second questions are subservient to the third.

- 1) *How are digital supplies classified for consumption tax purposes?*
- 2) *How is the place of supply decided for digital supplies and what consequences do these rules have for cross-border B2C supplies?*
- 3) *Does the legal framework lead to a rational consumption taxation of digital supplies?*

The first research question, *how digital supplies are classified for consumption tax purposes*, is relevant since it decides the applicability of the rules that settles the place of supply and the applicable rate. It covers Australian and Canadian GST as well as EC VAT. It is also relevant to evaluate the classification of digital

<sup>14</sup> Art. 234 EC.

<sup>15</sup> See e.g. Alhager, Eleonor, *Mervärdesskatt vid omstruktureringar* (Uppsala: Iustus förlag, 2001), p. 39-120.

<sup>16</sup> International co-ordination refers to international policy co-ordination between states regarding international taxation, i.e. which underlying principles decide which state that has the right to tax which transaction.

<sup>17</sup> Double taxation is further discussed in Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.5.5.

<sup>18</sup> The same terminology is used by the OECD, see e.g. The Application of Consumption Taxes to the Trade in International Services and Intangibles, 30 June 2004. The evaluation model used in this study is also based on OECD materials and using the OECD terminology creates consistency even if the EU, Canada or Australia may use differing terminology.

<sup>19</sup> OECD, Electronic Commerce: Taxation Framework Conditions. A Report by the Committee on Fiscal Affairs as presented to Ministers at the OECD Ministerial Conference, “A Borderless World: Realising the Potential of Electronic Commerce”, 8 October, 1998.

supplies in the current systems since it may affect if supplies are taxed in more than one jurisdiction or not in any jurisdiction.

The second research question, *how is the place of supply decided for digital supplies and what consequences do these rules have for cross-border B2C supplies*, covers if there are risks for double taxation or unintentional non-taxation of digital supplies in cross-border situations. Double taxation as well as non-taxation lead to distortions within the consumption tax systems, affecting competition between suppliers and perhaps also states due to a risk of an erosion of the tax base. The research question covers Australian and Canadian GST as well as EC VAT.

The third research question, which the first and second question are subservient to, is *if the legal framework leads to a rational consumption taxation of digital supplies?* The evaluation focuses on the international co-ordination perspective of the findings from the first and second questions. The rationality of these findings is analysed through the use of the evaluation model. The international co-ordination perspective further covers if there are cases of double taxation or unintentional non-taxation? If so, what causes for double taxation and unintentional non-taxation can be identified? Are there possible remedies internationally or in EC VAT, Australian GST or Canadian GST that can be identified? The third research question further covers how the different causes and remedies for double taxation or unintentional non-taxation affects the principles in the evaluation model, based on the OECD Framework Conditions, and how they correspond to each other.

### 3 Evaluating Rationality through the Use of an Evaluation Model

#### Creating an Evaluation Model

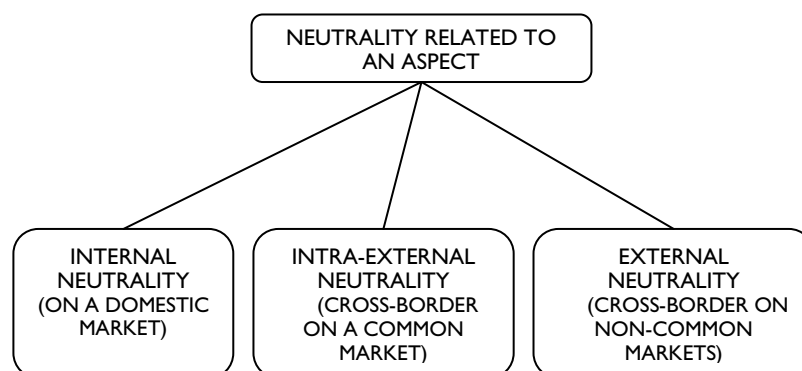
Before the three research questions of the aim are evaluated the different principles that are part of the OECD Framework Conditions are discussed from an EU, Australian and Canadian perspective. Furthermore, different aspects discussed in literature are brought into the discussion. The use of the different principles as part of an evaluation model is further explained in the following sections.

#### Neutrality as Used in this Study

Neutrality is an evaluation tool full of nuances.<sup>20</sup> To be kept in mind is the relativity of neutrality. A certain aspect or phenomena affects if a tax is neutral or not. Thus neutrality cannot be used without being related to such an aspect or phenomena. One example of such an aspect may be competition between lawful and unlawful acts. The term *functional equivalency* as used in Canadian GST is comparable to the OECD definition. Different forms of commerce should be treated equally, as well as taxpayers carrying out exchangeable supplies. Functional equivalency may be treated as part of competition neutrality even if different authors may position functional equivalency on different levels.<sup>21</sup> Equally the definition falls into the scope of competition neutrality relating the taxation of e-commerce to more traditional types of commerce. For the purposes of this study where the consumption tax treatment of cross-border supplies are evaluated, it is also suitable relating neutrality to the degree of cross-border activity as shown in Figure 3-3

<sup>20</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 3.2.1-3.2.4.

<sup>21</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Figure 3-1 and 3-2 in section 3.2.4.



**Figure 3-3 Neutrality in a Cross-Border Environment**

Neutrality can generally be discussed at three different levels, at an internal, intra-external and external level. This is valid for all different nuances of neutrality. Neutrality thus needs to be related to an aspect such as suppliers or exchangeable supplies and which level the principle is comparing these suppliers or suppliers at.

Figure 3-3 is one way of clarifying neutrality in an international context. Neutrality is examined in relation to a specified aspect and the analysis can be clarified through using neutrality at different levels, *i.e.* if it is used at an internal, intra-external or external level. By relating neutrality to an aspect *e.g.* comparing traditional commerce and e-commerce, a greater clarification may be reached. Thus a tax can never be neutral as such, since neutrality needs to be related to a certain aspect such as the treatment of exchangeable supplies. This treatment can be more or less neutral. The *internal neutrality* refers to trade on a domestic market. Exchangeable products or services meet the same tax consequences or economic operators are treated similarly for tax purposes. For consumption tax purposes this is important if supplying companies are to be able to compete on equal terms especially considering the use of different tax rates on exchangeable supplies. These aspects also strive for functional equivalency as in the definition in the Framework Conditions and parts of competition neutrality as discussed above.

The *intra-external neutrality* refers to cross-border situations in an internal market. For example, EC law prohibits discrimination and restrictions of the freedom of movement of goods, services, capital and establishment within the EU.<sup>22</sup> The VAT should accordingly not affect trade on the internal market. Suppliers located in different Member States should be able to compete on equal terms. The intra-external neutrality is thus related to markets where common goals exist. This is comparable to external neutrality as it is discussed and defined by several authors.<sup>23</sup>

The *external neutrality* refers to the neutrality or lack of neutrality between suppliers established in countries not part of the same common market, *e.g.* a supplier established in a Member State of the EU and a supplier established in Canada. External neutrality differs from internal and intra-external neutrality since common taxation goals between these states often are non-existing due to the states' sovereignty. Through the work by the OECD, some common goals may be said to exist. But due to the soft law character of these guidelines and principles, the states are not obliged to follow these common goals as in the EU, where Member States have a treaty-based obligation to comply with, and enforce, EC law.<sup>24</sup> In areas where common goals or policies are non-existing there is still a need for evaluating the cross-border taxation and whether it is neutral in certain aspects or not.

<sup>22</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 2.2.2 for a further discussion of the freedom to provide and receive services.

<sup>23</sup> See *e.g.* Alhager, Eleonor, *Mervärdesskatt vid omstruktureringar* (Uppsala: Iustus förlag, 2001), Lindencrona, Gustaf, *Skatter och kapitalflykt: beskattningens inverkan på det finansiella kapitalets och dess ägares rörlighet över Sveriges gränser mot bakgrund av den pågående ekonomiska integrationen i Västeuropa* (Stockholm: Jurist- och samhällsvetareförbundets Förlags AB, 1972) and Westberg, Björn, *Nordisk mervärdesskatterätt – behandlingen av utländska företag, varor eller tjänster inom ramen för nationella lagar* (Stockholm: Juristförlaget, 1994).

<sup>24</sup> This is further discussed in Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 2.2.3.

Neutrality related to a specific aspect often includes that it is used as a tool for measuring possible effects of the suppliers' ability to compete on equal terms. Neutrality issues at all three levels, *i.e.* internal, intra-external and external, exists for digital supplies.

At an internal level one may need to distinguish between different exchangeable digital supplies from digital supplies that are exchangeable with traditional supplies. There is also the question of how to treat combined or bundled supplies which are linked to the treatment of exchangeable supplies.

At an intra-external level within the EU a problem with differing rates could cause neutrality distortions both for exchangeable supplies and their suppliers and between Member States, if risks for tax evasion exist in between the different Member States. The cross-border movement of digital supplies challenges this and the free movement provisions.

In Canada the differing rates also exist between the different provinces. But since neutrality is not used as an interpretative tool by the Canadian courts as by the ECJ, the neutrality issues are likely to differ. The issues still exist at a policy level, but the Courts do not have the same role as the ECJ since the Canadian provincial sales taxes are not harmonised by the GST that exists at a federal level as the national legislations of the EU Member States is harmonised by the EC VAT. Australia on the other hand, is not an actor at an intra-external level in this sense since the GST in Australia only applies at a federal level, and no additional state consumption taxes exist.

At an external level neutrality can be questioned since common policy goals generally do not exist in the same sense between independent states, not bound by cooperative treaties. For the development of e-commerce and the cross-border trade with digital supplies, this is, however, still an important level to discuss. A lack of certain neutrality aspects at an external level might affect both suppliers and states concerning difficulties to compete or loss of tax revenue. It could also lead to risks for, or cases of, double taxation and unintentional non-taxation.

### Efficiency as Used in this Study

Efficiency is relative, just as neutrality is. Furthermore, efficiency is commonly known as an economic principle. Looking at taxation, efficiency might be far more crucial than neutrality. From a state perspective an inefficient tax system does not fulfil its purpose of bringing in revenue to the state if it is compared to costs related to its inefficiency such as market distortions and compliance costs. However, it is important also to remember that efficiency may not be the primal goal for governments, since other interests are more important, *e.g.* welfare. Neutrality and efficiency may also be difficult to separate as in the Canadian use of neutrality.<sup>25</sup>

Looking closely at the trade with digital supplies, there is an obvious need for invoking the discussion of loss of revenue for the states. How much are they prepared to lose? Suppliers can use the legislative differences to avoid taxes in the same regard as the complexity can hinder the suppliers from fully using the available advantages of e-commerce and cross-border activities. This means that not only revenue from the consumption tax systems is lost, but income from the taxation of the companies providing digital supplies is diminished. It is easy for the companies to move to countries with lower tax rates, or change the organisation of the companies. They are no longer in need of any other means of delivery but the Internet, or other means of distance communication.

Efficiency is in the Framework Conditions related to the efficiency of the tax legislation. If compliance costs and administrative costs are extensive, the motive for complying with the legislation is weakened. This could then be held to be an efficiency loss. If efficiency, in this sense, instead is reached; the compliance costs are low for the companies liable to tax. This may be referred to as a *legally efficient* legislation.

Since the administrative aspects are out of the scope of this study, legal efficiency is only used as a base for comparing the appreciated compliance burden on the supplying companies. The applicable legislations complexity is assumed to affect the compliance burden for the companies, *i.e.* more complex rules are assumed to increase the compliance costs and more explicit rules to decrease it. Such obstacles may affect the possibilities for global trade and lead to a post-globalisation as discussed above.

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<sup>25</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.3.

### Certainty and Simplicity as Used in this Study

Having certainty and simplicity as goals for drafting legislation is essential for fulfilling several other principles in the Framework Conditions. To decrease compliance and administrative costs and reach legally efficient legislation, the tax payers must be able to foresee the consequences of their business decisions. Certainty and simplicity may, however, be difficult to uphold which may make it impossible to attain legal efficiency and also aspects of neutrality may be impossible to attain. Instead focus may be kept on simplifying other parts such as possibilities to use electronic signatures and communicate information electronically including allowing electronic submissions of VAT returns.

In this study certainty and simplicity are complementary to some extent to the other criteria as well as fundamental. By complementary, it is understood that certainty and simplicity correlate to neutrality as well as legal efficiency. If the applicable legislation leads to certainty with respect to predictability of tax consequences for the persons liable to tax, and thereby are simple to understand and follow, the compliance costs are kept at a lower level. Neutrality could be connected to certainty and simplicity if the degree of functional equivalency could increase by achieving certainty and simplicity.

Certainty and simplicity are important for the taxable persons. The link to compliance costs for those acting on several markets with a high degree of cross-border supplies to consumers is important to be aware of and evaluate legislative changes from this perspective. Legal efficiency may be impossible to achieve unless legislation is clear and the taxable persons can foresee tax consequences by their activities. In an area such as e-commerce the rapid technical evolution creates an extra strain on the applicable rules, which in itself causes difficulties for taxable persons as well as tax authorities.

### Effectiveness and Fairness as Used in this Study

Effectiveness and fairness are criteria that raise both administrative and legal issues. Following the definition from the OECD, effectiveness primarily aims at the effectiveness of the tax as such, *i.e.* the right amount of tax at the right time. This can be compared to efficiency, which is closely linked to the concept of effectiveness. One difference that can be identified between effectiveness and efficiency is that effectiveness is more focused on the actions of the taxpayers and the actions of the tax authorities, striving towards a suitable degree of compliance and control in order to reach the goal of producing the right amount of tax at the right time, while efficiency is measuring the costs of *e.g.* the administrative burden for suppliers, which may be one factor making the taxation less effective. One example of such costs could be related to having a GAAR and additional measures to enforce tax legislation.

Questions on effectiveness related to the costs for reaching the objective of the right amount of tax at the right time are kept outside the scope of the study since measuring these costs would require an independent study. Hence, effectiveness is used as an evaluation tool focusing on the assumed risks for double taxation or unintentional non-taxation where the assumption is based on if conflicting principles are used for classification of supplies and determination of the place of supply. This could affect the vendors' ability or will to comply with applicable legislation.

Fairness, on the other hand, implies fairness from the perspective of minimising tax avoidance and risks for tax evasion. This could be seen both from a taxable person's perspective and from a state perspective. Minimising the potential for tax evasion and avoidance on the other hand need to be considered from a perspective of the complexity of the legislation. A link to the criteria on certainty and simplicity is clearly visible. If one can achieve a high degree of simplicity and certainty this could also lead to a higher degree of fairness. Similarities are also found in the correlation between legal efficiency, certainty and simplicity. In an international context this cannot merely be achieved at a national level, but through international consensus.

Problems with enforcing consumption tax on B2C e-commerce have already been presented.<sup>26</sup> One example of a problem which affect the effectiveness and fairness of the tax is a difficulty in identifying the geographical location of the consumers. In relation to this it is problematic to enforce collection obligations on remote Internet retailers.<sup>27</sup> On the basis of this discussion the effectiveness can be separated

<sup>26</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.1.

<sup>27</sup> See Cockfield, Arthur J, "The Law and Economics of Digital Taxation: Challenges to Traditional Tax Laws and Principles", 56 *Bulletin for International Fiscal Documentation* 12 (2002), p. 616.

into two different issues, a legal issue and an administrative issue.<sup>28</sup> The legal issue is connected to the discussion on effectiveness above and can be described as assuming that vendors comply with the applicable legislation and administrative issues. Legal issues are related to question on guiding principles for determining the place of supply, *i.e.* the country of origin or the country of destination, and determinations on what constitutes presence in the applicable jurisdiction.<sup>29</sup> These legal issues often result in double taxation or unintentional non-taxation, which is not in line with an effective and fair tax.

The administrative issue covers the difficulties in enforcing legislation on transactions to consumers in the jurisdiction where the supplies should be taxed due to that those vendors are located outside the jurisdiction. The administrative difficulties lie not only in enforcing legislation and locating the supplier but concern problems of identifying the taxable transaction and the value of the consideration.<sup>30</sup> Since the administrative issues are delimited from the scope of this study, they are not further analysed in the evaluation.<sup>31</sup>

Using legal effectiveness in a similar manners to legal efficiency is one way of keeping the focus on the core issues of this study. Double taxation or unintentional non-taxation is neither neutral in relation to functional equivalency nor certain, effective or fair. Deciding the place of the suppliers and the place of consumption is vital for reaching legal effectiveness.<sup>32</sup> Minimising risks for tax evasion and tax avoidance are important when evaluating legislation and its competitive effects on suppliers. The link to certainty and simplicity is also crucial to understand and may help reaching a higher degree of fairness. The evaluation model implies that methods for combating tax avoidance need to be considered from an international co-ordination perspective analysing possible remedies for double taxation and unintentional non-taxation.

### Flexibility as Used in this Study

Flexibility is an underlying principle for taxing e-commerce as such but also for reaching the goals of the other principles in the Framework Conditions. Flexibility as defined in the Framework Conditions is a key issue for the future taxation of e-commerce and especially digital supplies. Flexibility can lead to *e.g.* certainty and simplicity if the application of the rules is clear and can be controlled. The interconnection is important to observe, especially keeping in mind the difficulties with composite supplies. On the other hand, flexibility could also be an argument for using a more general and open language in legislative provisions to ensure that future technological changes may not necessarily require additional legislative changes. In such cases flexibility could also be held to decrease certainty if it affects the possibility to predict the tax consequences for the persons liable to tax. This effect could, however, be reduced by using interpretative guidelines until case law has had the possibility to develop. Such a shift could, however, have constitutional effects which would need to be considered carefully before any alterations are made.

Questions on the flexibility of legislative proposals are difficult and cannot be answered with legal certainty, but merely result in speculations. On the other hand, the flexibility of the legislation must be kept in mind when analysing issues related to e-commerce.

The OECD has, also in later reports, added that the difficulties with taxing e-commerce are not only related to e-commerce, but also due to the increase of cross-border trade, market access and globalisation among other things.<sup>33</sup> Flexibility could then also involve legislation coping with an ongoing development in society.

<sup>28</sup> See McLure, Charels E Jr, "Tax Competition in a Digital World", 57 *Bulletin for International Taxation* 4 (2003), p. 150.

<sup>29</sup> See McLure, Charels E Jr, "Tax Competition in a Digital World", 57 *Bulletin for International Taxation* 4 (2003), p. 151.

<sup>30</sup> See McLure, Charels E Jr, "Tax Competition in a Digital World", 57 *Bulletin for International Taxation* 4 (2003), p. 151.

<sup>31</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.3 for further delimitations.

<sup>32</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 3.7.1-3.7.2 for further discussions of the place of consumption.

<sup>33</sup> See *e.g.* OECD, Implementation of the Ottawa Taxation Framework Conditions, The 2003 Report, p. 33.

## The Evaluation Model

With all of the above identified criteria at hand, the complexity of evaluating the taxation of digital supplies according to the Framework Conditions is clearly identifiable. To bring clarity to the different criteria and their correlation it is useful imagining a spider's -web. Straining different digital supplies through this spider's-web gives an evaluation of the advantages as well as disadvantages of the existing legislation and proposals at hand.

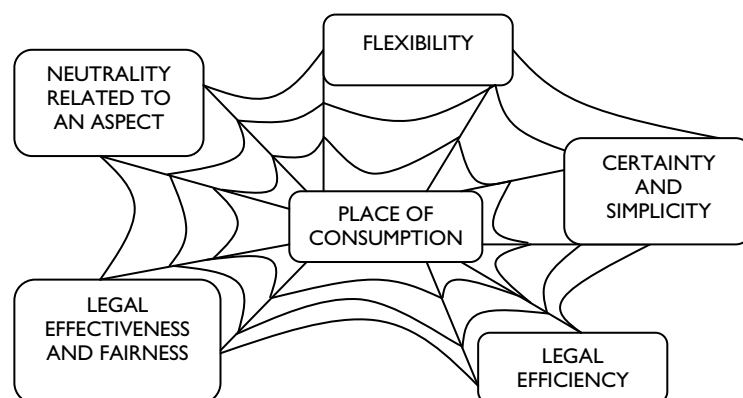


Figure 3-4 The Spider's Web as an Evaluation Model

The Spider's Web illustrates how the different principles in the evaluation model correlate. The centre determines the place of supply and which criteria that are used to do so. Depending on which objectives that are ranked the highest, other principles in the evaluation model may be set aside. One example is where the EU strives for a functioning internal market, setting neutrality related to competition on an intra-external level high, whereas other principles are not at all used in the same manner

Figure 3-4 gives an overview of the complexity of the evaluation model. The different criteria are connected to each other, corresponding as well as conflicting. The *place of consumption* is in the centre of the Spider's Web affecting the other criteria in the evaluation model. The place of consumption may, however, also be affected by the other criteria. Defining the place of consumption homogeneously is one of the keys to avoiding non-taxation as well as double taxation. To identify how states identify the place of consumption, *i.e.* which criteria they use for deciding the place of supply in existing legislation is a key issue for clarifying the intended application of consumption taxation to digital supplies.

One example of when the criteria have been given different meanings is the use of neutrality and efficiency in Canada compared to the European view of neutrality in EC VAT. In the Spider's Web it is, however, neutrality as used in this study, that is used as an evaluation tool.<sup>34</sup> The degree of neutrality of an aspect, *e.g.* competitiveness, is dependent on the degree of cross-border activity, where this study uses internal, intra-external and external neutrality as specifying three different degrees of the cross-border activity. Legal efficiency, on the other hand, as used here in the evaluation describes the compliance burden of the supplying companies. Neutrality and legal efficiency can then be said to be complementary to one another.

Legal efficiency, in turn, depends on the degree of simplicity and certainty. If a supplier can foresee the tax consequences and rely upon the legislation, the more legally efficient the legislation may become. Neutrality can also be connected to certainty and simplicity if the degree of functional equivalency increases by achieving certainty and simplicity. Certainty and simplicity can be said to be complementary in one sense since it correlates to both neutrality and legal efficiency. The criteria may, however, also be said to be fundamental to another extent since it affects the degree of neutrality and legal efficiency.

The criteria of effectiveness and fairness may also be connected to legal efficiency and certainty and simplicity. In an international context this criteria cannot merely be met at a national level, but through international consensus. Legal issues related to questions on guiding principles for determining the place

<sup>34</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.5 and Figure 3-3 for a further explanation of how neutrality is used in this study.

of supply, *i.e.* the country of origin or the country of destination<sup>35</sup>, and determinations on what constitutes presence in the applicable jurisdiction need to be appraised in the light of effectiveness and fairness. These legal issues often result in legal double-taxation or non-taxation, which is not in line with an effective and fair tax. Using legal effectiveness in a similar manner to legal efficiency is one way of keeping the focus on the core issues of this study.

Cases of double taxation or unintentional non-taxation is neither neutral in relation to functional equivalency, nor certain, effective or fair. The link to certainty and simplicity is important to understand and uphold to reach the criteria of fairness. Due to rapid technical changes and the development of bundled supplies the flexibility of the tax legislation is important for reaching certainty and simplicity as well as the criteria of neutrality, legal efficiency and fairness. The Spider's Web serves as a model to evaluate the rationality of the consumption taxation of digital supplies.

#### 4 Criteria for Imposing VAT/GST on Digital Supplies

The issues for imposing VAT and GST on digital supplies concerns several issues. Three main issues is discussed concerning distinguishing digital supplies from tangible property or goods, how to treat bundled or composite supplies and the basic characteristics a digital supply needs to fulfil to constitute a taxable supply. All these issues are equally valid for traditional commerce and are not always clearly applied. The issues specifically dealing with electronic commerce in B2C transactions are mostly related to the lack of clear guidance on how to transfer criteria used for traditional commerce onto digital supplies. They are also related to the technical developments creating a larger strain on these concepts than before.

Predictability is highly dependent on the ability of making prognoses of how courts would interpret different supplies. Several rules today combined with different styles of interpretation increases complexity, thus neither simplicity nor certainty if measured by predictability is upheld by the current rules. If certainty on the other hand is measured by fairness perhaps a case-by-case approach leads to a higher degree of fairness unless also predictability is needed to do so. Because of the different approaches to taxable persons or commercial activity the scope of the digital supplies that are seen as taxable vary between the different jurisdictions, where the EU has the widest scope.

All three jurisdictions appraise the basic criteria of taxable supplies to the definition of supplies as such, that these need to be supplied for consideration and that they need to be supplied within the course of a business or commercial activity. The basics are thereby to a large extent very similar. There are some differences regarding the scope of the different criteria, mainly related to the interpretation and different considerations that need to be upheld by courts. Within the EU the ECJ interprets the VAT as not hindering the free competition on the internal market, whereas this consideration needs not to be upheld by Canadian and Australian courts. Furthermore, the ECJ strongly upholds fiscal neutrality between lawful and unlawful acts. This is not found in Canadian or Australian GST.

The scope of the criteria used for taxable person, and particularly economic activity is wider in EC VAT than the comparable criteria used in Canadian and Australian GST. The EC VAT criteria do not entail a demand for reasonable profit in the same sense as in Australian and Canadian comparable definitions. Thus individuals not seen as taxable persons in Australia and Canada may fulfil the criteria of being a taxable person in EC VAT, particularly considering that consideration for taxable supplies do not necessarily need to be given in money, but need to be able to be expressed in a nominal value. If the ECJ would interpret EC VAT strictly following its previous case law on fiscal neutrality, illegal downloads could perhaps be taxed if consumed within the EU. Such an interpretation of EC VAT would, however, probably be seen as highly controversial, but still likely to be in line with the principles used for interpreting EC VAT to protect the free movement of services and to protect the tax base within EU. Consequences of such an interpretation must, however, also be set into perspective of the possibility to enforce VAT on such supplies. How such an interpretation could be in line with principles of legal certainty and predictability, may, however, be more difficult to justify.

Based on the differences and similarities between the criteria for imposing consumption taxation on digital supplies a few remarks could be made. First of all it is likely that most legal digital supplies provided to consumers fulfil the criteria described in this section. Considering the problems with unintentional non-taxation the supplies of illegal materials is one major cause for these distortions. If these distortions are to be solved, further analyses of the possibility to tax *e.g.* Pirate Bay need to be discussed

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<sup>35</sup> Principles governing the place of supply are further discussed in Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.1.

together with other suppliers of illegal materials. Such analyses require a lot of detailed information that only could be gathered through the assistance of national authorities. Because of this the analysis in this study can merely focus on the possibilities of taxing these supplies, pinpointing possible issues that need to be further analysed. The main issues to consider are if Pirate Bay can be regarded as a taxable person and if a direct link between the supplies and the consumers can be established and the exchange of files thereby can be held to be a consideration.

Several similarities and an interesting difference between the three jurisdictions exist concerning the treatment of combined or mixed supplies. The terminology differs, but the interpretative considerations and principles developed in case law show many similarities. It is especially interesting to note the effects of UK case law in Australia where ECJ case law indirectly may affect the interpretation of Australian GST. This may, however, change when further case law exits from Australian courts, but principles may still be found to survive even in a longer perspective. The comparison is unbalanced since Australian case law need to be further developed before interpretative methods can be established; even so a few remarks may be made.

In all three jurisdictions the purchaser's view is considered, both if it is a consumer and where the purchaser is another taxable company. The principles are, however, less outspoken in Australian GST, clarifying more a common sense approach, where decisions must be taken considering the different aspects related to each individual case.

The end result in an evaluation using the Australian approach compared to using the Canadian or EU approach may, however, not always differ just because of the differences between the approaches as such. Each individual case is unique and it is the circumstances in the case that affects the final result. A supplier offering digital supplies to consumers need, however, to be aware of how the supply is marketed since it may affect if packages of supplies are bundled or treated as single supplies, as well as how the terms of use are formulated and presented before the consumer.

The approaches on how to deal with combined or bundled supplies do not vary as much as the approaches for taxable supplies or commercial activity, but there are clear risks of similar supplies being treated differently because of how they *e.g.* have been marketed. If this leads to that exchangeable supplies are taxed differently neutrality related to competition between exchangeable supplies on any level is not upheld. Thus distortions in competition exist both at an internal, intra-external and external level.

The basic criteria imposing VAT and GST on digital supplies and how bundled and combined supplies are taxed, could be causes for double taxation and unintentional non-taxation since they cause possible overlaps and gaps in between the jurisdictions scope of their national consumption taxes. In solving the problems with unintentional non-taxation there is a need for considering the scope of the basic criteria establishing the taxable supplies and the taxable persons carrying out economic activity or commercial activity, depending on which terminology ones chooses to use. Hence, these basic characteristics need to be considered to try to solve the issues with double taxation and unintentional non-taxation at both an international and national level.

## 5 The Results from the Comparison of the Classification of Digital Supplies

Telecommunication services are explicitly categorised as a type of services on their own in all three jurisdictions. All three jurisdictions have the same basic concepts of transmitting, emitting and receiving different types of signal as telecommunication services. The difference between the jurisdictions' definitions of telecommunication services is partially related to the treatment of radio and television broadcasting services. The Australian treatment is somewhat unclear whereas EC VAT has these types of services as a separate category of services. The objective and scope of radio and television broadcasting services in EC VAT is, however, not completely clear. The uncertainty is partly related to the distinction between telecommunication services and radio and television broadcasting services but partly also due to the scope of electronically supplied services. Considering the speed of technological developments, the distinctions between these types of supplies may be difficult to uphold. A clarification at an EU level is necessary to avoid differing interpretations at a national level in the Member States and to increase predictability for operators on the market.

Both Canadian GST and EC VAT have potential risks for double taxation built into the classification systems. Both electronically supplied services (EU) and intangible personal property (CAN) are distinguished from other types of services using the criteria of minimum human involvement. The degree of human involvement may differ between different digital supplies since these can be fully automatised such as when downloading music files, or require limited human involvement such as automated distance teaching and still be seen as an electronically supplied service. Traditional services such as a lawyer or

accountant helping a client are distinguished from both electronically supplied services and intangible personal property based on if they require more than a minimum human involvement. The use of digital signatures and possibilities to automatise standard contracts could alter the degree of human involvement to such an extent that these services could fall into the scope of electronically supplied services or intangible personal property.

Such changes need to be considered in interpreting the scope of electronically supplied services and intangible personal property. There may also be a need for considering if the right criteria are used for deciding the place of supply if such alterations are made. How would neutrality, efficiency and the other principles of the evaluation model be affected? Would there be a shift in the tax base and what consequences would follow such a shift?

Neutrality related to the treatment of exchangeable or functionally equivalent supplies at an internal level<sup>36</sup> is threatened by the current rules. Even if the rules of today may be justified as preferable compared to previous rules in EC VAT, one still has to ask – are they sufficient? Companies supplying digital supplies in cross-border situations are likely to have problems predicting the tax consequences of their supplies. This creates uncertainty at the same time as it opens up for tax planning opportunities.

At an intra-external level there may be distortions between suppliers established in different EU Member States selling exchangeable supplies. Such distortions could be caused by differing interpretations and applications of how supplies are classified at a national level. As a result of such differences there may also be cases of double taxation and unintentional non-taxation. At an external level there are potential risks for double taxation and unintentional non-taxation since the classifications differ between different jurisdictions. To which extent such risks exist is, however, dependent on which criteria that are used for deciding the place of supply.

States with a simplistic view on these issues and that work on facilitating for supplying companies (the taxable persons in B2C e-commerce) can attract e-commerce business to re-locate their business or a permanent establishment. Whereas states with high tax rates such as Sweden and Denmark (25 per cent) risk losing tax revenue if companies could reach a competitive tax advantage by reallocating their businesses supplies to states with a lower VAT/GST rate. These conclusions are, however, based on that technological facilities available for conducting e-commerce in a competitive manner are equally high in these states.

Of the three jurisdictions compared in this study, Australia has the most simplistic approach. This leads to uncertainty, due to problems finding guidelines in combination with little or no case law in the specific area. Australian GST is, however, the youngest of the three VAT systems, whereby this is likely to change as case law develops. At the same time, the simplistic approach concerning classifications shifts focus from the classification as such, onto if the supply is done in, or connected to, Australia. This could also increase certainty if this increases the predictability for the suppliers. EC VAT is the most complex system with diversified classifications into several subgroups of services. In all three systems this creates higher compliance costs for the supplying companies, thus legal efficiency<sup>37</sup> is difficult to uphold. The systems may, however, still be held to uphold certainty considering the case-by-case approach that seems to be the way forward in the courts. This argument is, however, valid for all three jurisdictions. Certainty would increase if the rules had a higher degree of simplicity.

Comparing the three jurisdictions all of them should aim for a simplistic approach but in combination with high quality guidance published by the CRA, ATO or the VAT Committee. If this could be met, the rules for classifying digital supplies could be more comprehensible and easier to understand. Both Australia and Canada generally have high quality guidance published by the CRA and the ATO, even if the CRA has developed the use of examples further than the ATO. The EC VAT approach is more complex but this is also a result of the need to harmonise legislation at a national level of the Member States.

The classification as such may be overlapping or not corresponding fully, but the effects of this classification cannot be analysed without considering where the supplies are deemed to be made. If guidance cannot be given at an EU level within the EU or at a federal level in Canada and Australia new boundaries for a global e-commerce may be created. In Australia and Canada the problems are, however, less likely to create distortions than in the EU. The main reason for this is Australia and Canada for GST purposes have less complex divisions of rights between federal and provincial level than in the EU. From

<sup>36</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.4.

<sup>37</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.8.

an international coordination perspective it would be even better if this guidance could be given at an international level. The main reason for this is to minimise the risks of creating new boundaries, leading to a regionalisation of e-commerce.

## 6 Advantages and Disadvantages with the Current Rules Deciding The Place of Supply

The study of the three different jurisdictions rules concerning the place of supply for digital supplies leads to various conclusions. The advantages are that all jurisdictions have acknowledged the issue of taxing B2C e-commerce with digital supplies and are aware of the problems related to this. The approaches in the different jurisdictions on how to deal with this differ considerably. The EU aim of protecting the harmonised tax base and the functioning of the internal market has led to a pro-active approach in EC VAT. As a result of this, a large scope of differing classifications of digital supplies and a wide range of digital supplies that effectively are and can be taxed within the EU exist. Whereas the Australian approach is more post-active protecting what currently is needed to be protected from an Australian perspective and keep compliance costs and administrative costs low. The Canadian approach is also pro-active in the sense that the guidance published by the CRA is specifically dealing with issues of supplying and purchasing digital supplies, but tries to cope with this within existing legal framework.

One disadvantage with all three jurisdictions is the high degree of uncertainty for suppliers to predict the tax consequences of their behaviour, even if there are differences between the jurisdictions. The jurisdiction that provides the most guidelines and where a specific case from the Federal Court of Appeal also exists is Canadian GST. In Australia the guidance published by the ATO are generally valuable but gives little specific guidelines for e-commerce business.

The use of Regulation 1777/2005 in EC VAT is a step in the right direction, but further guidance as given within Canadian GST, is probably necessary to avoid a regionalisation within the EU, where Member States in smaller groups or on their own, develop such guidelines without fully considering the EU perspective. It would be possible for the VAT Committee to issue further guidelines where the CRA materials can be inspirational, since a Regulation might be an unsuitable form for such a material.

There are cases of double taxation specifically in between Canadian GST and EC VAT, due to the use of differing criteria for deciding the place of supply and differing interpretative styles. There are potentially also cases of double non-taxation where supplies to consumers within Australia may not be taxed under Australian GST unless the supplying company carries on an enterprise connected to Australia or has a permanent establishment there.

The examples of Consumer X, Y and Z show two specific cases of double taxation. One where Consumer X that is resident in Sweden, purchases a standard contract by downloading it while on vacation in Canada. This supply is subject to tax both under EC VAT and Canadian GST. Equally the supply where Consumer Z phones a friend in Australia using an IP-telephone which is subject to tax both under Canadian GST and Australian GST if the billing location is in Canada.

Where risks of double taxation exist, supplying companies are likely to try to avoid raising their costs and their burden of the applicable consumption tax. Double taxation may be an incentive for a company to avoid taxation. Thus states will have increased costs for trying to enforce these rules to e-commerce transactions to consumers.

As for the classification as such for different digital supplies the neutrality issues also are valid in the evaluation of the rules concerning the place of supply. At an intra-external level, which is valid both for EC VAT and for Canadian GST, Member States with a lower VAT rate or provinces with no or a lower Provincial Sales Tax (PST) rate can attract suppliers to establish fixed or permanent establishments to gain a competitive tax advantage. At an external level neutrality also cannot be upheld where cases of double taxation exist, which a comparison of the CRA guidance and the Canadian case *Dawn's Place* show.<sup>38</sup>

Because of the established cases of double taxation and also the potential risks of cases of double taxation, legal efficiency of the consumption tax systems is low. The companies supplying digital supplies have large compliance costs where double taxation cases exist. Structures such as the one-stop-shop scheme within EC VAT eases the burden for the suppliers where double taxation does not exist, but are still demanding. The evaluation also shows that the effectiveness and fairness of the current rules can be questioned. Even if all three jurisdictions agree upon the principles that are part of the Framework Conditions and basically aims for reaching the principal objective of taxing digital supplies at the place of

<sup>38</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.3.3.

consumption, differing terminology and interpretations of the criteria used for deciding place of supply, show that a stronger international co-ordination is needed both considering the scope of place of consumption as such, but also considering how to reach this objective. Both tax authorities and courts and their interpretative methods need to be part of such a coordination.

Thus the main conclusion is that, as long as cases of double taxation exist, none of the principles in the evaluation model can be reached, because double taxation is as such not in line with the basic functions of a consumption tax system following a value added tax model.

## 7 Cases of Double Taxation

Cases of double taxation can occur due to differing classifications between jurisdictions of the same transaction. It can also occur where supplies are classified as the same type of service but differing criteria are used in deciding the place of supply in the jurisdictions the supply is connected with. A third reason for double taxation is differing interpretations of similar criteria, where at least one jurisdiction widens the scope of a criterion to secure the tax base within that state.

The comparative study of the different classifications showed that telecommunication supplies had a varying scope in EC VAT, Canadian GST and Australian GST. EC VAT has the narrowest scope of telecommunication services and Canadian GST is likely to have the widest scope of these services. There is uncertainty as to how radio and television broadcasting services are treated in Australian GST.<sup>39</sup> The scope of telecommunication supplies in Australian GST seem, however, to be most comparable with Canadian GST even if the definition as such is comparable to the definition of telecommunication services in EC VAT.

When telecommunication supplies are compared from a cross-border perspective, it is, however, not as likely that the difference in scope of the classification leads to double taxation. This risk depends on how other supplies, such as radio and television broadcasting supplies are defined and which proxies that are used for deciding the place of supply for these services. The potential risks for double taxation are thereby more dependent on how the criteria for establishing place of supply are interpreted and applied in each individual case.

Radio and television broadcasting fall under the same rules for deciding the place of supply as telecommunication supplies in Canada and Australia, but are classified as a separate type of service in EC VAT.<sup>40</sup> The same criteria are, however, used for deciding the place of supply for these services as for telecommunication supplies. Radio and television broadcasting services may be difficult to distinguish both from telecommunication supplies and from electronically supplied services in EC VAT. One could question the existence of a separate classification of these supplies. Does it not just cause a greater uncertainty about which type of supply that falls under which classification? These supplies could equally be classified as telecommunication supplies or electronically supplied services. Considering the complexity of e-commerce transactions, there are great risks of increasing complexity due to the amount of bundled supplies.

Electronically supplied services cover a large part of digital supplies within EC VAT. The comparable scope of supplies, in Canadian GST, fall under intangible personal property and telecommunication services. In the Australian GST the comparable scope is supplies of anything else, such as creations, advice and information and telecommunication services which possibly cover broadcasting services. For these types of supplies, cases of double taxation have been identified just as for telecommunication supplies. One example of such a case is where the schedule for zero-rated supplies in Canadian GST does not apply and the supply is considered to be made in Canada. It is important to consider the role of how the criteria deciding the place of supply are interpreted and the applicability of zero-rated schemes. A narrow interpretation of the latter and a wide interpretation of the first lead to the wide scope that Canadian GST has.

One could question if such a wide scope is in line with taxing these supplies at the place of consumption. A wide interpretation of the zero-rated scheme may on the other hand, lead to loss of tax revenue for the Canadian state. One important question is, however, where most revenue is lost – on companies trying to organise their business to avoid double taxation or where companies established in

<sup>39</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.4.2.

<sup>40</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.4

Canada are able to compete with non-Canadian suppliers due to a more generous interpretation of the zero-rated scheme?

In Australian GST there are less risks of double taxation between supplies falling under the scope of *things* and electronically supplied services in EC VAT. The main reason for this is that Australian GST use different criteria for deciding the place of supply than Canadian GST. The criteria in Australia are not as overlapping as the criteria used in Canadian GST. The effects of the criteria deciding the place of supply are, however, even more dependent on how the provisions are interpreted and applied by courts. Little guidance is given by the Australian Tax Office (ATO) for e-commerce business and case law is rare. As guidelines and case law are developing these effects may need to be further considered.

Between Australian GST and Canadian GST there are also potential cases of double taxation. Hence, the same conclusions as drawn between Australian GST and EC VAT are valid also for supplies between Canada and Australia.

Digital supplies that are taxed as services in Canadian GST or traditional services in EC VAT also show risks for cases of double taxation. The three jurisdictions that are part of the comparative study use differing criteria for deciding where the supplies are deemed to be made. If criteria in two or more jurisdictions are met, this will lead to a case of double taxation.<sup>41</sup>

*How do these cases and risks for double taxation relate to the evaluation model?* Neutrality distortions occur at different levels. Where consumers choose between exchangeable supplies, supplies that can be held to be functionally equivalent, price is an important factor, however, not always the most important. Where transactions are taxed in more than one jurisdiction, it is still the supplying company that is liable to tax.<sup>42</sup> Can companies fully transfer the burden of the consumption tax onto the consumer and still compete with other actors on the market? It is likely that the burden cannot be fully transferred without suffering from a competitive disadvantage, thus neutrality at an external level is threatened.

As held in the forming of the evaluation model independent states do not have external neutrality as a policy goal, since other objectives are valued higher, such as protecting the tax base and securing the welfare system within a state. Also the Framework Conditions are, as far as neutrality is concerned, aiming for internal neutrality where electronic commerce should not be taxed in such a way that these supplies are treated less favourably for a consumer when compared to traditional commerce.<sup>43</sup> Other reports from the OECD also consider external neutrality where issues with double taxation and non-taxation are discussed for cross-border trade in services and intangibles.<sup>44</sup> Later work on these issues from the OECD primarily deals, however, with B2B commerce.<sup>45</sup>

External neutrality may be held to be given priority considering the ongoing work within the OECD of establishing international VAT/GST guidelines and the acknowledgement of double taxation and non-taxation problems in cross-border e-commerce.<sup>46</sup> From a constitutional perspective further agreements are needed between independent states to hold that external neutrality is a common policy goal. It is an objective for the OECD, but not a common tax policy for the OECD Member States in the sense that all OECD Member States have agreed through a convention to uphold this policy.<sup>47</sup>

Between the EU Member States double taxation should not occur since the criteria for deciding the place of supply are harmonised. There are, however, potential risks that the criteria are interpreted and applied differently at a national level in the Member States. Cases of double taxation are therefore likely to occur. This distorts the intra-external neutrality since the consumption tax affects the supplying companies structuring of their business and also consumer choices.

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<sup>41</sup> See e.g. Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.3.3 for a further discussion of when these risks may occur.

<sup>42</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 4.4.1.2.

<sup>43</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.1.

<sup>44</sup> See OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, 30 June 2004, para. 17.

<sup>45</sup> See OECD, *Applying VAT/GST to Cross-Border Trade in Services and Intangibles – Emerging Concepts for Defining Place of Taxation*, January 2008.

<sup>46</sup> See OECD, *International VAT/GST Guidelines*, February 2006 and *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, 30 June 2004, para. 30.

<sup>47</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 2.5 for a discussion of OECD materials. The OECD materials on external neutrality can today not be held to have the status of a convention, but more the status of common understandings.

Cases of double taxation in cross-border situations affect internal neutrality to the same extent as at an intra-external or external level. If exchangeable supplies are treated differently on a domestic market non-established and established suppliers would be treated differently if the cross-border supply from the non-established supplier is subject to tax in more than one jurisdiction. At an internal level competitive distortions also occur if *e.g.* exchangeable supplies are taxed with different rates. Hence, this would require that digital supplies are taxed at the same rate regardless of how they are classified and how competing goods or tangible property are classified for consumption tax purposes.

Cases of double taxation also lead to efficiency distortions as well as distortions of fairness and effectiveness. Double taxation leads to higher compliance costs both from a business perspective and from a state perspective.<sup>48</sup> The companies will try to avoid that their supplies are subject to double taxation which is likely to challenge the thin line between tax planning and tax avoidance. The states carry the costs for monitoring and controlling the consumption tax system. If B2C transactions are seen as difficult to administer and control in e-commerce business, provisions causing double taxation of these transactions increase these difficulties.

The approach in EC VAT, Australian GST and Canadian GST to use guidelines or other interpretative assistance differs. The Canadian approach with guidelines from the Canada Revenue Agency (CRA) is helpful and could well be matched within the EU and Australia, where less specific guidelines for e-commerce exists. Clear guidelines help taxable persons when trying to predict the tax consequences of their business, especially where little case law exists. Thus guidelines as within Canadian GST may be held to increase certainty. The level of certainty depends, however, on if the courts reach the same conclusions as the CRA or other authorities that develop similar guidelines. The Australian approach is trying to keep the rules simple and this is something that both Canadian GST and EC VAT could strive for. This conclusion is especially valid for EC VAT due to the adoption of rules in different stages without interpretative tools such as guidelines to assist. It could be argued that the VAT Committee gives this guidance or at least should give similar guidelines. In such cases this work need to be given priority.

In *Commission v Germany*<sup>49</sup> the ECJ does not follow previously issued guidelines nor does it go against them. The case concerns the place of supply of the service of an executor of a will. In this case the Commission holds that Germany is in breach of Community law.<sup>50</sup> The Commission argues that the VAT Committee guideline for the tracing of heirs is accurate also for executors of a will, although the guidelines as such are not binding.<sup>51</sup> The ECJ holds, however, the opposite. The reasoning from the ECJ does not argue from the point of view of the VAT Committee guidelines but their arguments are based on a comparison between a lawyer and an executor of a will.<sup>52</sup>

The background to the decision may be found in the Opinion of *AG Bot* explaining the difference between the VAT Committee guidelines and the services in the particular case.<sup>53</sup> The ECJ does not, however, bring up the same argumentation as *AG Bot* in its decision. That the ECJ does not refer to the VAT Committee guidelines in this case may not lead to the conclusion that the VAT Committee guidelines as such have little value. It is just as likely that the ECJ finds the guidelines inapplicable to this case because of the line of reasoning used by the Commission is wrong. Hence, the interpretative method used by the ECJ in this case follows previous case law, comparing different types of services and their purposes.

Regulation 1777/2005 is a start within EC VAT to increase a uniform application of EC VAT at a Member State level. Where further guidelines at an EC level is lacking, the Member States are likely to continue to develop their own administrative practices which could create new obstacles and cause double taxation in intra-community transactions. Differences between language versions also need to be avoided as far as possible and there is room for improvement on this issue.<sup>54</sup>

<sup>48</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.3.5 for a discussion of legal efficiency.

<sup>49</sup> Case C-401/06 Commission of the European Communities v Federal Republic of Germany [2007] ECR I-609

<sup>50</sup> See case C-401/06 Commission of the European Communities v Federal Republic of Germany [2007] ECR I-609, paras. 9-10.

<sup>51</sup> See case C-401/06 Commission of the European Communities v Federal Republic of Germany [2007] ECR I-609, para. 18.

<sup>52</sup> See case C-401/06 Commission of the European Communities v Federal Republic of Germany [2007] ECR I-609, paras. 39-42.

<sup>53</sup> See Opinion of Advocate General Bot in Case C-401/06 Commission of the European Communities v Federal Republic of Germany [2007] ECR I-609, para. 50.

<sup>54</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.3 where differences in language versions of Regulation 1777/2005 are presented.

In forming the evaluation model, it is held that effectiveness and fairness cannot be reached without international consensus on how to tax B2C e-commerce.<sup>55</sup> Several states should probably argue that this already has been done through the Framework Conditions. Since differing interpretations of *e.g.* the place of consumption and the use of differing criteria for deciding the place of supply exists, problems with cases of double taxation are not solved through international tools such as the Framework Conditions. Perhaps it is necessary to look closer at the possibility to use tax treaties or international guidelines to help solve the problem with double taxation also for consumption tax purposes.<sup>56</sup>

The OECD divides the rules concerning the place of supply for different states into two main categories. The first is named *the European approach* and EC VAT rules are central in this group.<sup>57</sup> The other category is named *the New World approach* which covers both Canada and Australia.<sup>58</sup> The European approach is heavily dependent on the classifications of the supplies to be able to apply the destination principle or the origin principle to decide where the supplies are taxed. The Australians and Canadians are instead heavily dependent on identifying factors to connect the supply to the jurisdiction rather than classifying the supply as such. The risks for double taxation and unintentional double non-taxation still exist even between countries using the same approach, since differences in interpretation of the decisive factors may still lead to such a result.

The same conclusions are also valid for bundled or composite supplies. Depending on how these supplies are treated individual cases of double taxation may well occur. This is mainly due to different interpretations of the circumstances in a case and of differing applications of doctrines of splitting supplies into two or more separate supplies or bundling supplies under the predominant part of the supply.<sup>59</sup>

## 8 Cases of Unintentional Non-Taxation

Cases of unintentional non-taxation are more difficult to find, since the comparative study of EC VAT, Canadian GST and Australian GST rather shows the opposite problem, where transactions are taxed in more than one jurisdiction. The OECD holds, however, that the risks for non-taxation are as frequent as the risks for double taxation due to the symmetric nature of VAT and GST.<sup>60</sup>

In Australian GST the more narrow use of consumption taxation of B2C e-commerce transactions purchased by Australian consumers from non-established suppliers may lead to non-taxation. But if this is qualified as unintentional non-taxation is more difficult to hold since the policy work in Australia holds that this non-taxation is intended. The compliance costs for enforcing taxation on these supplies are high and the ATO has stressed that international agreement and co-operation is needed for developing solutions.<sup>61</sup> Hence, the policy may change when the costs for enforcing such taxes can be decreased by international coordination and cooperation.

Another interesting issue to discuss considering unintentional non-taxation is the vast exchange of illegal materials on-line. Would it be possible to tax peer-to-peer exchanges of illegal copyright materials on-line, since the value of the exchanged files could fulfil the criteria of consideration in all three jurisdictions?<sup>62</sup> These illegal activities compete with legally transferred materials. Thus it will be difficult reaching a level playing field and fairness unless solutions to these problems can be found.

If the ECJ argumentation is used in these cases, fiscal neutrality between legal and illegal supplies are not upheld.<sup>63</sup> Still, if it is difficult to enforce consumption taxation on legally traded materials in B2C e-commerce, does this mean that it is even more difficult in illegal commerce? It would, indeed, be interesting to see how a court would argue in such a case. Another question is, however, if these illegal files are supplied within an economic activity or commercial activity and thereby can be subject to consumption taxation. The scope of taxable persons and taxable transactions may not cover the suppliers

<sup>55</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.8.

<sup>56</sup> This is further discussed in Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.6.

<sup>57</sup> See OECD, Report from the Consumption Tax TAG: Implementation Issues for Taxation for Electronic Commerce, para. 11.

<sup>58</sup> See OECD, Report from the Consumption Tax TAG: Implementation Issues for Taxation for Electronic Commerce, para. 15.

<sup>59</sup> See section 4.3.4.

<sup>60</sup> See OECD, The Application of Consumption Taxes to the Trade in International Services and Intangibles, 30 June 2004, para. 30.

<sup>61</sup> See ATO: Tax and the Internet: Second Report (1999), para. 7.4.10.

<sup>62</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 4.4.1.1, section 4.4.2 and section 4.4.3.

<sup>63</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.2.

of illegal materials. Further research need to be done in this area. The EC VAT concept of taxable persons is wider than the Canadian and Australian use of commercial activity due to their criteria of reasonable expectation on profit.<sup>64</sup> The distinctions concerning the degree of profitability will decide the differences in the scope of these consumption taxes.

Where cases of unintentional double non-taxation occur, the rules considering tax avoidance also need to be observed and set in relation to the possible solutions for taxing different digital supplies. There are thereby two separate issues that need to be considered, where the first issue is to decide if and how to tax non-taxed digital supplies. Hence, is it intentional or unintentional non-taxation? The OECD approach is to understand why cases of unintentional double non-taxation occur. Their suggested causes for unintentional non-taxation are conflicting rules concerning the place of supply, inconsistent definitions of supplies, contradictory results due to zero-rating schemes or differences in the treatment of bundled supplies.<sup>65</sup> Considering the symmetric nature of consumption taxation, the suggested causes of unintentional non-taxation are supported by the findings in this study.<sup>66</sup>

*How do cases of unintentional non-taxation affect the rationality of consumption tax systems following the evaluation model?* Neutrality at an external level is distorted by cases of double-taxation since the supplier may not be able to fully transfer the consumption tax onto the consumer. Equally non-taxation creates an advantage where transactions that are not taxed in any jurisdiction compete with transactions taxed in one (or more) jurisdictions. Intra-external neutrality could be distorted within the EU where supplies are treated differently at a national level, some taxed in one state, others in two states and others in none of the states within the EU.

At an internal level neutrality is distorted if exchangeable supplies are not able to compete on equal terms. Such cases exist between illegal and legal supplies, since illegal supplies on-line are either for free or exchanged for access to other illegal materials. Consumer behaviour needs to be considered in the discussions on how to continue to deal with the competitive distortions caused by extensive illegal downloads. If the uploaders are held to be involved in commercial activity, which may be held in cases like Pirate Bay, these transactions could be taxed if found to be supplied from a taxable person to a consumer. These illegal supplies create neutrality distortions on both the internal, intra-external and external level.

In cases of non-taxation the compliance burden for the supplying companies is low. If the objective of the consumption tax systems is to create a general taxation of consumption, efficiency is distorted if a general taxation cannot be upheld, as for *e.g.* illegal supplies. Other objectives may be given priority, such as allowing non-taxation due to the costs for the state to control and monitor the consumption tax, compared to possible revenue gain. In such cases legal effectiveness is upheld at the cost of legal efficiency. If non-taxation distorts fairness or not, depends on which perspective that is taken in the evaluation. From a state perspective it may still be fair since, equivalent supplies are taxed, or not taxed, on equal terms. It could, however, be even more important to strive for upholding neutrality on all levels to create a level playing field with fair taxation or fair non-taxation of supplies. A tax that cannot uphold fairness and efficiency may be difficult for states to legitimise for persons liable to tax. This could also lead to low incentives for complying with the tax.

Certainty and simplicity may be upheld if there are clear distinctions between which supplies that should be taxed and not. These distinctions also need to be justified even though neutrality between exchangeable supplies cannot be upheld in such cases. In the current systems, Australia is the jurisdiction with the highest degree of allowed non-taxation of B2C e-commerce with digital supplies.<sup>67</sup>

A key issue solving cases of unintentional double non-taxation for states is to decide the policy framework. The Framework Conditions from 1998 are a good starting point and it is time to realise the principles that are part of the Framework Conditions into sound practices. In doing so further international coordination and cooperation is needed.

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<sup>64</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 4.4.2 and section 4.4.3.

<sup>65</sup> OECD, Report from the Consumption Tax TAG: Implementation Issues for Taxation for Electronic Commerce, para. 29.

<sup>66</sup> See particularly Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 4.3 concerning bundled supplies, section 5.5 concerning differences in classifications, 6.5 concerning conflicting place of supply rules and the application of zero-rated schemes.

<sup>67</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.4.3.

## 9 Final Conclusions

### The Task

This study aims at *evaluating if the cross-border consumption taxation of digital supplies is rational from an international co-ordination perspective*.<sup>68</sup> For reaching this aim, three research questions are used. The first two research questions; how are digital supplies classified for consumption tax purposes and how is the place of supply decided for digital supplies and what consequences do these rules have for cross-border B2C supplies, are subservient to the third research question. The third research question is if the legal framework leads to a rational consumption taxation of digital supplies. The second research question particularly covers if there are risks for double taxation or unintentional non-taxation. Furthermore, the study covers a comparison of EC VAT, Australian GST and Canadian GST.

Rationality is evaluated through the use of an evaluation model based on the Framework Conditions.<sup>69</sup> Rationality then refers to that the consumption taxation of digital supplies is rational if the principles that are part of the Framework Conditions are upheld. The principles that are part of the Framework Conditions are neutrality, efficiency, certainty and simplicity, effectiveness and fairness and flexibility. These principles could also be described as policy objectives.<sup>70</sup> At the centre of the evaluation model is the place of consumption which serves as the goal for where digital supplies should be taxed. The other principles form a Spider's Web surrounding this central concept.<sup>71</sup>

For identifying potential cases of double taxation or unintentional non-taxation a comparative method is used in this study. By comparing different jurisdictions, possible advantages and disadvantages with the current provisions can be identified. Using a comparative method could also answer questions such as; what are the cause of double taxation and unintentional non-taxation.

The principles that are part of the evaluation model could correlate as well as conflict. The complexity of these principles is also affected by their different perspectives and diverging scopes in the three evaluated jurisdictions.<sup>72</sup> One such example is the use of neutrality. Neutrality has a diversified meaning and needs to be related to what is evaluated. Within EC VAT neutrality is not only used as an underlying policy goal for the structure and functioning of the VAT but it is also used as an evaluation tool by the ECJ when interpreting the provisions of EC VAT.<sup>73</sup> Within Australian and Canadian GST neutrality is used as an underlying tax policy, but not as an interpretative tool. The Canadian use of efficiency also covers parts of the use of neutrality as it is used in EC VAT.<sup>74</sup>

In this study efficiency has been used as a tool for considering legal efficiency focusing on the estimated compliance costs for the supplying companies.<sup>75</sup> Neutrality and legal efficiency are often complementary since legal efficiency cannot be upheld where exchangeable supplies or suppliers in the same competitive situation cannot be equally taxed; hence neutrality distortions then refer to both an internal level, intra-external level and external level. The negative effects on legal efficiency due to these distortions mainly occur due to the complexity caused by inconsistencies between *e.g.* exchangeable supplies.

Legal efficiency and neutrality both depend upon certainty and simplicity since rules that are easier to understand and written in a clear and simple matter are likely to increase both of them. For cross-border

<sup>68</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), chapter 1.2.

<sup>69</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.1

<sup>70</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.1 for a further discussion.

<sup>71</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Figure 3-4 in section 3.8.

<sup>72</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 3.2.2-3.2.3, 3.3.2-3.3.3, 3.4.2-3.4.3, 3.5.2-3.5.3 and 3.6.2-3.6.3.

<sup>73</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.2.

<sup>74</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.5.

<sup>75</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.3.5.

taxation this cannot be reached solely at a national or regional level, but need to be reached through international consensus.<sup>76</sup>

Certainty and simplicity also correlates with legal effectiveness and fairness. Legal effectiveness refers to the costs for imposing the right amount of tax at the right time. It thereby covers measures and costs for enforcing the legislation which also is connected with if a jurisdiction has anti-avoidance rules.<sup>77</sup> The correlation between certainty and simplicity and legal effectiveness and fairness is that complex provisions may lead to neutrality distortions. Neutrality distortions between suppliers in the same competitive situation are not considered to be fair. Similarly, more complex rules are likely to raise the administrative costs for states and authorities to enforce and control them, which decrease the legal effectiveness of these provisions.

It is also held that flexibility covers the objective of keeping the rules general enough to cope with technological changes and the transformation and development of different digital supplies. If flexibility is not upheld it distorts neutrality as well as certainty and simplicity. Hence, it indirectly affects the other principles of the evaluation model as well.<sup>78</sup>

To structure the different issues for cross-border trade, neutrality is discussed at three different levels. Neutrality has traditionally been discussed in terms of internal and external neutrality.<sup>79</sup> For this evaluation it is useful to discuss neutrality in terms of internal, intra-external and external neutrality, since they relate to three different levels. Internal neutrality refers to a national market without the cross-border aspects and may then also be described as functional equivalency between exchangeable supplies and suppliers in a comparable competitive situation. Intra-external neutrality refers to cross-border trade on a common market as within the EU. External neutrality refers to cross-border trade where common policy goals usually do not exist, as between independent states.<sup>80</sup>

The centre of the Spider's Web is the place of consumption. The place of consumption is the agreed objective of where digital supplies to consumers should be taxed.<sup>81</sup> There are, however, differences in how the place of consumption is decided upon in different jurisdictions. Such differences affect if there are risks for double taxation and unintentional non-taxation.

## The Classification of Digital Supplies

The classification of digital supplies decides which rules concerning the place of supply that apply to the transaction and thereby also which jurisdiction that has the right to tax that transaction. Comparing different classifications and the scope of the types of supply is not an aim in itself but is necessary to establish if there are potential risks for double taxation or unintentional non-taxation. Hence, this part of the study aims at answering the first research question of the aim; how are digital supplies classified for consumption tax purposes.

The evaluation is carried out through the use of a comparative method, covering EC VAT, Australian GST and Canadian GST.<sup>82</sup> Digital supplies have a large scope, especially within EC VAT where the scope covers at least up to ten different types of services.<sup>83</sup> Within Canadian GST the comparable scope of types of supplies are limited to three types of supplies.<sup>84</sup> If financial supplies are included, Australian GST has three types of supplies that could cover digital supplies. If financial supplies are not considered as part of

<sup>76</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.8.

<sup>77</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.5.5.

<sup>78</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.8.

<sup>79</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.3.

<sup>80</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.5.

<sup>81</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 3.7.1 and 3.7.2.

<sup>82</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.4.

<sup>83</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Figure 5-3 in section 5.2.1.

<sup>84</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Figure 5-6 in section 5.3.1.

digital supplies, Australia has the most simplistic approach, covering only two categories of supplies. Further subgroups can be identified but these follow the same rules concerning the place of supply.<sup>85</sup>

The classification of digital supplies can be summarised to cover two different categories where the first covers services that can be supplied from a distance and the second covers traditional services which can, in part or in whole, be supplied in a digital form. This can schematically be summarised as in Table 8-1.

**Table 8-1 Schematic Overview of the Classification of Digital Supplies in EC VAT, Canadian GST and Australian GST**

	<b>EC VAT</b>	<b>Canadian GST</b>	<b>Australian GST</b>
<b>Distance based services</b>	Telecommunication services	Telecommunication services	Telecommunication supplies
	Radio and television broadcasting services		
	Electronically supplied services	Intangible personal property	Supplies of anything else (also referred to as things)
<b>Traditional services requiring more than a minimum of human intervention</b>	Transfers and assignments of rights	Services	
	Consultancy services, data processing and information		
	Cultural and similar services		
	Advertising services		
	Services related to immovable property		

All three jurisdictions treat telecommunication services as one specific type of supply with its own set of rules. The scope of telecommunication services differ, however, between the compared jurisdictions. The definition found in EC VAT has the narrowest scope whereas the Canadian definition for GST purposes has the largest scope. The range between these two definitions is, however, not extensive since the definitions are based upon the same conceptual understanding.<sup>86</sup> The main difference in the scope of telecommunication services in EC VAT and Canadian GST is that telecommunication services in Canadian GST also cover radio- and television broadcasting services. In EC VAT these supplies are treated as a separate type of supply.<sup>87</sup> Australian GST is somewhat unclear on whether radio- and television broadcasting services are covered by the scope of telecommunication services. Hence, the conclusions for Australian GST are uncertain on this point.<sup>88</sup>

EC VAT introduced a specific type of supply for covering digital downloads and digital access of supplies through directive 2002/38/EC. This category of supplies is referred to as electronically supplied services. These services have as a criterion that they require minimum human involvement and cannot be supplied without the use of electronic networks. Neither Canadian GST nor Australian GST has introduced a similar type of supply. These jurisdictions treat the equivalent supplies, requiring minimum human involvement, as intangible personal property (CAN) or as supplies of anything else (AUS).<sup>89</sup>

The scope of intangible personal property in Canadian GST or supplies of anything else in Australian GST are not directly comparable to the scope of electronically supplied services in EC VAT. The

<sup>85</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Figure 5-7 in section 5.4.1.

<sup>86</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.3.2.

<sup>87</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.4.

<sup>88</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.4.2.

<sup>89</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 5.2.3, 5.3.3 and 5.4.3.

distinction between intangible personal property and services in Canadian GST is, however, based on the degree of human involvement. This criterion is also used to distinguish electronically supplied services from other traditional services in EC VAT. Supplies of anything else in Australian GST do not refer to the same distinction.<sup>90</sup>

Electronically supplied services were not defined in directive 2002/38/EC, instead this directive supplied an illustrative list of types of supplies that should be classified as electronically supplied services. Regulation 1777/2005 was adopted 17 October 2005 and is directly applicable in all the EU Member States. It aims at reaching a more uniform application of the EC VAT provisions at a national level in the Member States and it is built upon the previous work of the VAT Committee. Through Regulation 1777/2005 a more general definition which stipulates the criteria discussed above, was introduced. Regulation 1777/2005 gives further guidance than the EC VAT directive itself concerning the scope of electronically supplied services, but there are few steps brought forward in Regulation 1777/2005 if compared with the work the VAT Committee had done before.<sup>91</sup>

There is also a quality problem regarding the language versions. Between the four different versions that are compared in this study, two mistakes have been found. One of the mistakes is found in the English version where downloading of music is referred to in Annex I, item 4.d.<sup>92</sup> The Swedish, French and German versions refer to downloading of games in this indent. Downloading of music is covered by Annex I, item 4.a in Regulation 1777/2005. The second mistake is found in the Swedish version which refers to advertising (*reklam*) instead of advertising services (*reklamtjänster*).<sup>93</sup> The English, French and German versions refer to advertising services which is a narrower concept than advertising.

One issue that none of the three jurisdictions explicitly deals with is the possibility for consumers to use digital signatures for accessing and purchasing also other types of supplies, traditionally seen as services that require a larger degree of human involvement and how this might challenge the current classifications. These more traditional services are classified as different types of services, where other criteria for deciding the place of supply apply. Focus for these types of supplies is kept on where the supplier performs the service or where it may be used.<sup>94</sup> It is likely that a larger scope of these traditional services can be supplied with minimum human intervention and would require the use of information networks for its supply. Hence, these supplies would fulfil the general definition of electronically supplied services in EC VAT and the factors for classifying a supply as one of intangible personal property in Canadian GST.<sup>95</sup>

The transformation of services from traditional supplies to digital supplies and the mixture of digital supplies consisting of several different parts is challenging for the consumption tax systems. The use of coherent principles for deciding how to treat mixed or bundled supplies heavily affects the efficiency, neutrality and simplicity of the consumption taxation of these supplies. There exists similarities between the three jurisdictions in this area, and it is interesting to note the effect that the reasoning from the ECJ might have on Australian GST, since their courts tend to consider cases both from New Zealand and the UK and the UK which is an EU Member State. When more case law from different Australian courts exist, this connection might be weakened but this would from a constitutional perspective be interesting to evaluate further. All three jurisdictions consider the perspective of the purchaser and the specific circumstances in each individual case, which is possibly the fairest approach for the suppliers, since each case is unique. The suppliers must, however, be aware of the consequences their marketing might have for how their supplies are taxed.<sup>96</sup>

Because of the different approaches in the three jurisdictions for classifying supplies, there are risks for double taxation and unintentional non-taxation, dependent on how the criteria are interpreted and applied to different cases. The differences in the approaches cause neutrality distortions at an internal level

<sup>90</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.5.

<sup>91</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.3.

<sup>92</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Table 5-4, item 9 (d), in section 5.2.3.

<sup>93</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Table 5-5, item k, in section 5.2.3.

<sup>94</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 5.2.6-5.2.9, 5.3.4 and 5.4.3.

<sup>95</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 5.2.11 and 5.3.5.

<sup>96</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 4.3.4.

since exchangeable supplies do not fall under the same set of criteria in the different jurisdictions, which is likely to lead to neutrality distortions also at an external level.<sup>97</sup>

In B2C e-commerce there is also a competitive distortion between lawful and illegal supplies. The Swedish case on Pirate Bay illustrates this problem. The main issues to consider are if Pirate Bay can be regarded as a taxable person and if a direct link between the supplies and the consumers can be established and the exchange of files thereby can be held to be a consideration.<sup>98</sup> There may be possibilities to tax these supplies at least considering the ECJ use of fiscal neutrality.<sup>99</sup> But since both Australian and Canadian GST opens up the possibility to tax illegal supplies it could equally be so in these jurisdictions as well. Their courts do not, however, use the same style of interpretation considering neutrality aspects as the ECJ, whereby policy decisions and legislative changes might be needed.

The rules for classifying the supplies cannot be considered as clear and simple, but rather complex and where measures have been taken for improving the system as within EC VAT, the complexity has increased. The main objective for the changes that have been made in EC VAT has been to secure taxation of services consumed on the internal market. Hence, following the principles in the evaluation model, taxation at the place of consumption may be held higher than certainty and simplicity, but the main cause could equally be to protect the tax base within the EU. Under such circumstances it is more likely that it is neutrality that is held higher than certainty and simplicity, rather than the place of consumption since the provisions in EC VAT were introduced to secure taxation of supplies from non-established suppliers to consumers resident in an EU Member State. By doing so the supplies to EU consumers would be taxed independently of if the suppliers are established within the EU or not.

### Consequences for Deciding the Place of Supply

The rules concerning the place of supply decide which jurisdiction that has the right to tax a transaction. The scope of which types of supplies that fall under the concept of digital supplies, as used in this study, have been identified.<sup>100</sup> This section aims at answering how the rules concerning the place of supply are affected by the classification of digital supplies. Hence, this corresponds to the second research question of the aim.<sup>101</sup> This research question also covers if there are risks for double taxation or double non-taxation. The evaluation is carried out through the use of a comparative method.<sup>102</sup> The compared consumption tax systems are EC VAT, Australian GST and Canadian GST.

An incorrect classification could lead to a misapplication of the criteria deciding the place of supply since these may differ between types of supplies.<sup>103</sup> Hence, an incorrect classification of a supply could lead to a case of double taxation or unintentional non-taxation. On a policy level all three jurisdictions also acknowledge the difficulties with taxing B2C transactions of digital supplies.<sup>104</sup>

The EU, Canada and Australia have agreed that the policy goal for where digital supplies should be taxed is the place of consumption.<sup>105</sup> The place of consumption then refers to where the consumer is resident or usually resides. However, the approaches in how to establish the place of consumption differ between the three jurisdictions. The principal basis for the three jurisdictions' rules concerning the place

<sup>97</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.5.

<sup>98</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 4.4 for a further discussion of the possibilities to consumption tax illegal supplies.

<sup>99</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.2.2.

<sup>100</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), chapter 5 and section 8.2.

<sup>101</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.2.

<sup>102</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.4 for a further discussion of the comparative method.

<sup>103</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.1

<sup>104</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.1.

<sup>105</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 3.7.

of supply is then the same but the proxies used for reaching this objective differ.<sup>106</sup> EC VAT uses either the origin principle or the destination principle as the main rules for most digital supplies. Canadian GST and Australian GST uses proxies referring to if the supply can be used, is performed or supplied in connection to Canada or Australia.<sup>107</sup> These differences may cause both double taxation and unintentional non-taxation.

The EU is the jurisdiction which has been most pro-active of the three jurisdictions, imposing a new type of supply with special schemes for non-established suppliers of electronically supplied services to EU consumers to protect the EU tax base and the competitiveness of suppliers of electronically supplied services established within the EU. The Australian approach is more post-active, focusing on keeping compliance costs low and reaching a high degree of efficiency and effectiveness. The Canadian approach is more comparable to the Australian approach even if the CRA has been active establishing guidelines on how different types of supplies in e-commerce should be taxed and in accordance with which rules. This increases the level of predictability for suppliers both those that are established in Canada and those that are not. Thus it increases the level of certainty and simplicity.<sup>108</sup>

Cases of double taxation have been identified between the three jurisdictions. These cases or potential risks for double taxation cover both telecommunication services and digital supplies that can be supplied from a distance with minimum human involvement. The Canadian case *Dawn's Place* is a clear example of double taxation. The supplies of intangible property, downloaded and accessed from a web site may be used in Canada, whereby they also should be taxed there. If the material is downloaded by a consumer resident in an EU Member State it should also be taxed in the state where the consumer is resident or usually resides as an electronically supplied service.<sup>109</sup> This is an example of double taxation due to different criteria used for deciding the place of consumption even if both jurisdictions have the same policy goal, to tax the supplies at the place of consumption.

Other causes for double-taxation are that similar concepts or criteria are interpreted differently. Telecommunication supplies basically follow the same criteria for deciding where they are supplied, but depending on how *e.g.* effective use and enjoyment is interpreted, double taxation or even unintentional non-taxation might occur.<sup>110</sup> This difference depends on both differing methods of interpretation used by the courts in the jurisdictions and differing interpretations of the circumstances in the actual case.<sup>111</sup>

Because of the problems with clear cases of double taxation and the large risks for potential double taxation in between the three jurisdictions, it is difficult upholding any of the principles in the evaluation model. This is also because double taxation and unintentional non-taxation is in itself in breach of the fundamental principle of taxing the added value in each step of the production- and distribution chain. It is also difficult for a supplier in a situation of double taxation to fully transfer the burden of the consumption tax to the final consumer, which increases the supplier's costs and also may become an incentive for increased tax avoidance. Hence, the current rules lead not only to distortions of the principles in the evaluation model and the fundamental basic principles of a value added tax, but they are a potential cause for increasing problems with tax avoidance. Since the rules also lead to problems with non-taxation they are also a cause for tax evasion if remedies for the problems cannot be found.

The main consequences of the current rules concerning the place of supply that are applicable to digital supplies is that they lead both to cases of double taxation and unintentional non-taxation.<sup>112</sup> The main causes for these cases have been identified as:

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<sup>106</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.1.

<sup>107</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.5.

<sup>108</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.5.

<sup>109</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 6.3.3.

<sup>110</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.2.

<sup>111</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 2.4.

<sup>112</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 7.2 and 7.3.

- Diverging interpretation and application of how agreed principles should be transferred into the VAT and GST systems.
- Differing classifications are used for digital supplies which poses problems on how to deal with single supplies as well as compound or bundled supplies.
- The vast trade with illegal supplies and its distortive effects on legal supplies of exchangeable products and services.
- Diverging criteria for deciding the place of supply and of how the place of consumption best is accomplished.
- Differing methods for interpreting the criteria deciding the place of supply leads to even wider differences, even where similar criteria or the same terminology is used within provisions.

Where cases of double taxation and unintentional non-taxation exist it is held that the consumption taxation of digital supplies in B2C commerce is not rational.<sup>113</sup> Before answering the overall aim of this study, there is, however, also a need to consider possible remedies that can be used both at a national and international level.

### Possible Remedies for Double Taxation and Unintentional Non-Taxation

Where cases of double taxation and unintentional non-taxation have been identified it affects the rationality of the consumption taxation negatively.<sup>114</sup> To what extent these affects occur also depends on if there are available means for combating cases of double taxation and unintentional non-taxation. Hence, to answer the third research question of the aim; if the current consumption taxation of B2C e-commerce leads to a rational tax result, these possible remedies need to be evaluated. Possible remedies could exist both at a national and international level. States and regional organisations such as the EU need to decide at what level the problems with double taxation and unintentional non-taxation should be attacked.

Within the EU, suggestions for a mechanism for dealing with individual cases of double taxation are discussed because of the problems with differing interpretations of both EC VAT provisions and differences in interpreting the circumstances in the individual cases.<sup>115</sup> One of the reasons for this is that the private law rules differ and this affects also the VAT and GST. Within Australian and Canadian GST similar solutions are not discussed. This is most likely because they do not have the same level of problems as within the EU with its 27 Member States.

A mechanism for combating double taxation in individual cases could be construed at a regional level as discussed within the EU. Such a mechanism would, however, not solve individual cases of double taxation where both an EU state and a non-EU state have the right to tax the same supply according to their respective consumption tax legislation. If a similar measure should be construed at an international level, also double taxation cases as in the later case could be solved at an individual level. Such a mechanism needs to be further evaluated from both an international law perspective and a constitutional perspective.

Both Canadian and Australian GST have developed a general anti avoidance rule (GAAR) covering GST.<sup>116</sup> These GAARs could help combating problems with tax avoidance. Hence, these measures could be used to solve cases of unintentional non-taxation. Within the EU a similar approach is reached through the doctrine of abusive practices.

At a national level in Canada and Australia and at a regional level in the EU, there is currently no measure to solve the problems with cases of double taxation. The only possible measure for dealing with unintentional non-taxation is the use of national GAARs or the doctrine on abusive practices within the EU.

Other possibilities at a national level and at a regional level could be to consider the causes for double taxation and unintentional non-taxation when adopting legislative provisions. Furthermore, these causes could be considered by tax authorities and courts in interpreting and applying the consumption taxation. Measures taken to combat double taxation and unintentional non-taxation at a regional level need to be

<sup>113</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.4.

<sup>114</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.4.

<sup>115</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.5.1.

<sup>116</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.5.2.

coordinated at an international level. There is otherwise a risk for creating new causes or increase existing causes for both double taxation and unintentional non-taxation.

The OECD is working with these issues and considers different possibilities for dealing with both double taxation and unintentional non-taxation.<sup>117</sup> The suggestions at an international level for dealing with double taxation and unintentional non-taxation concern:

- using the possibilities given in Art. 25 OECD MTC to extend the mutual agreement procedure to cover VAT and GST,
- developing advance rulings procedures,
- increase the information exchange mechanism, and
- to develop VAT/GST guidelines to reach a larger international consensus.

These four suggested approaches could both increase and perhaps also decrease the rationality of the consumption taxation.<sup>118</sup> The conclusions from the evaluation of how these suggestions affect the rationality of how B2C digital supplies are consumption taxed is that international VAT/GST guidelines need to be developed since it is the only suggestion that could directly affect the causes for double taxation. The international VAT/GST guidelines should, however, be developed to a model treaty that can serve as a base for both bilateral and multilateral treaties.<sup>119</sup> Preferably, the development of such a treaty could include a mutual agreement procedure with a possibility to use an arbitration process since this can solve individual cases of double taxation. To assist this procedure and for combating cases of unintentional non-taxation the mutual assistance between tax authorities and information exchange need to be improved. The joint EU/OECD convention could provide a legal framework for doing so.<sup>120</sup>

Summarising the rationality of consumption taxation of digital supplies in B2C e-commerce is not easily done. Since cases of double taxation and unintentional non-taxation exist the rationality of the consumption taxation is low, based on the findings from using the evaluation model. There are measures that exist that can improve the situation. To combat unintentional non-taxation the joint EU/OECD convention on information exchange in combination with the national GAARs and a further development of the doctrine of abusive practices in EC VAT could help in solving these problems. The measures exists, it is perhaps more a question of resources and prioritising these cases.

To further increase rationality, a model tax treaty for consumption tax purposes is needed. This could be reached by a further development of the International VAT/GST guidelines. Preferably the work would be done in cooperation between the OECD and the EU.

## Results

The overall aim of this study is to evaluate if the cross-border consumption taxation of digital supplies is rational from an international co-ordination perspective.<sup>121</sup> The evaluation of this aim has mainly been done through the use of three research questions:

- 1) *How are digital supplies classified for consumption tax purposes?*
- 2) *How is the place of supply decided for digital supplies and what consequences do these rules have for cross-border B2C supplies?*
- 3) *Does the legal framework lead to a rational consumption taxation of digital supplies?*

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<sup>117</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.6.1.

<sup>118</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.6.2.

<sup>119</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.6.2.7.

<sup>120</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.6.2.7.

<sup>121</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.2.

These research questions have been evaluated using a comparative method which Australian GST, Canadian GST and EC VAT is part of. The comparative method refers to a micro comparison of the three specified research questions; hence the comparative method does not cover a full comparison of the three legal orders and its effects on digital supplies.<sup>122</sup>

*The answer to the first research question* can shortly be answered by referring to Table 8-1 in section 8.2. This schematic overview is, however, only schematic and the more complex answer is that there is a large scope of digital supplies that constitute a complex set of rules in the three jurisdictions. There are no clear lines between different types of supplies in the compared jurisdictions, but both similarities and differences have been identified.<sup>123</sup>

The examples given in the introduction to this study concerning the three consumers purchasing different digital supplies could be used as an exemplification of the results of the comparison of the classification of digital supplies.<sup>124</sup> Consumer X resident in Sweden but on vacation in Canada downloads a standard contract from a Canadian webpage. This supply is treated as an electronically supplied service in EC VAT.<sup>125</sup> In Canadian GST it is treated as a supply of intangible personal property.<sup>126</sup> In Australian GST this is a supply of anything else.<sup>127</sup>

Consumer Y resident in Australia that downloads music files from a British webpage. In EC VAT it would also be classified as an electronically supplied service.<sup>128</sup> In Canadian GST this supply is similarly treated as a supply of intangible personal property.<sup>129</sup> In Australian GST this is also a supply of anything else as the example with Consumer X.<sup>130</sup>

When Consumer Z, resident in Canada uses an IP-telephone to phone a friend in Australia and when she later on watches a soccer game streamed to her computer, these are both classified as telecommunication services according to Canadian GST.<sup>131</sup> The EC VAT treatment of the first supply is that it would be considered as a supply of telecommunication services. The second supply is in EC VAT either a supply of a radio and television broadcasting service or an electronically supplied service. The EC VAT treatment is uncertain due to the lack of definition of radio and television broadcasting services and the lack of guidance for this particular type of supply in Regulation 1777/2005.<sup>132</sup> According to Australian GST, the phone call through an IP-telephone is a telecommunication supply. The streamed soccer game is more difficult to classify in Australian GST, since it is uncertain if broadcasting services are part of telecommunication services as in Canadian GST or part of supplies of anything else. It is not treated as a type of service with its own category as in EC VAT.

These examples show that there are uncertainties considering distinguishing digital supplies from each other. Further guidance at a national, regional or, preferably, at an international level is needed. The CRA materials in Canada are well developed covering e-commerce issues. Such guidelines could be developed both in Australia and on an EU level.<sup>133</sup> It could also be developed at an international level through International VAT/GST guidelines. At an EU level Regulation 1777/2005 has improved the situation

<sup>122</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.4.

<sup>123</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), sections 5.5 and 8.2.

<sup>124</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 1.1.

<sup>125</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.11.

<sup>126</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.3.3.

<sup>127</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.4.4.

<sup>128</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.3 and Table 5-4, indent 9 (a), based on Council Regulation (EC) No 1777/2005.

<sup>129</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.3.3.

<sup>130</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.4.4.

<sup>131</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.3.2.

<sup>132</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.11.

<sup>133</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 8.2.

compared to before a general definition of electronically supplied services was adopted. There are, however, differences in language versions which creates further uncertainties and risks for misinterpretation and diverging application of EC law at a national level.<sup>134</sup>

*The answer to the second research question* is mainly the identification of causes for double taxation and unintentional non-taxation. These causes are firstly, where interpretation and application of how principles, as those part of the Framework Conditions, should be transferred into the VAT and GST systems differs between jurisdictions. Secondly, different classifications are used for digital supplies as discussed above which leads to problems with combined and bundled supplies and differing treatments of such supplies in different jurisdictions. Thirdly, there are also diverging uses of the criteria that decide the place of supply for digital supplies in different jurisdictions. Fourthly, also the methods of interpretation concerning the criteria used for deciding the place of supply. Also the vast trade with illegal materials creates competitive distortions and is one of the causes for unintentional non-taxation.

The examples with Consumer X, Y and Z in the introductory chapter can also for this second research question, be used as an illustration of how the rules concerning the place of supply affects digital supplies in B2C e-commerce. These examples show two specific cases of double taxation. The first is where Consumer X which is resident in Sweden, purchases a standard contract by downloading it while on vacation in Canada. This supply is subject to tax both under EC VAT and Canadian GST. The second case of double taxation is the supply where Consumer Z phones a friend in Australia using an IP-telephone which is subject to tax both under Canadian GST and Australian GST if the billing location is in Canada.

*The answer to the third research question* is given by the use of the Spider's Web.<sup>135</sup> This is the evaluation model based on the Framework Conditions which is used for the evaluation of rationality from an international co-ordination perspective. The short answer to this research question is that the current consumption taxation of digital supplies is not rational.

Even though all three jurisdictions in this evaluation have agreed upon the Framework Conditions and that the supplies should be taxed at the place of consumption, this objective cannot be upheld. Even the different principles in the Framework Conditions are interpreted and used differently in the three jurisdictions which constitute obstacles in themselves for reaching these objectives.

The principles that are part of the evaluation model are affected by the determination of the place of consumption. Even if there is a common objective that the place of consumption should refer to where the consumer is resident or usually resides, differences in how this is implemented as discussed under the second research question, affects the other principles in the evaluation model. Neutrality distortions occur at both an internal, intra-external and external level.

- Internal level
  - Consumers' choices between exchangeable supplies.
  - Suppliers' choices on where to establish the business and to which countries supplies are made.
  - Suppliers' costs for distributing digital supplies and complying with tax legislation.
  - The burden of the consumption tax may not be fully transferred to the consumer.
- Intra-external level
  - Suppliers' choices on where to establish the business and to which countries supplies are made.
  - Distortions of the freedom to provide and receive services could occur if suppliers are taxed for the same transaction twice in intra-community supplies.
  - Consumers' choices may be *less* affected after 1 January 2015 and the shift to the principle of destination for deciding the place of supply, since the VAT rate where she is resident or usually resides always applies.

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<sup>134</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 5.2.3. The answer to the first research question is further elaborated in section 8.2.

<sup>135</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), Figure 3-4 in section 3.8.

- External level
  - Suppliers' choices on where to establish the business and to which countries supplies are made.
  - Suppliers' costs for distributing digital supplies and complying with tax legislation.
  - The burden of the consumption tax may not be fully transferred to the consumer.
  - Could increase tax competition between states.
  - Double taxation could lead to incentives for tax avoidance.
  - Could lead to a possible regionalisation of e-commerce instead of using its potential for a globalised market.

These distortions affect also the possibility to have legal efficient legislative provisions. Neutrality distortions affect the compliance costs for the supplying companies.<sup>136</sup> Legal efficiency is also negatively affected by unintentional non-taxation and extensive illegal downloads in B2C and C2C supplies. These cases of unintentional non-taxation also affect legal effectiveness negatively. Companies that try to compete with illegal materials may not be able to do so, especially not where double taxation of their legal supplies occur. The compliance costs for the suppliers of legal digital downloads would then further increase.

The costs for tax authorities to enforce the tax legislation will also rise when enforcing legislation on illegal supplies. This will affect the legal effectiveness negatively as well. Measures of combating tax avoidance may require costly audits and controls. The problems related to illegal supplies need to be given priority, not only from a copyright perspective, but also from a consumption tax perspective.

Combating cases of double taxation and unintentional non-taxation would increase both certainty and fairness for the suppliers. Legal efficiency and certainty are may be also increased by using simplistic provisions and qualitative guidelines. There is a difference between the EU and the two other jurisdictions that affects this possibility since EC VAT is harmonised at an EU level but applied at a national level. Hence, the EC provisions need to assure a high degree of harmonisation as a primary objective. Simplicity could still be improved and the VAT Committee could be used for adopting guidelines similar to those that exist for Canadian GST. The ATO would increase certainty and legal efficiency in Australian GST if specific examples covering e-commerce businesses would be added to the existing materials.

There are currently improvements that are implemented through the adoption of directive 2008/8/EC in EC VAT. This affects, however, only trade within the EU and not cross-border issues at an international level. Hence, stronger measures at an international level are needed if the degree of rationality is going to be increased.

Considering also the possible remedies for combating double taxation and unintentional non-taxation the measures that already exist could be further used. This primarily covers the use of information exchange systems and national GAARs as well as a further development of the doctrine of abusive practices in EC VAT. These two measures could help to combat the cases of unintentional non-taxation. In order to solve the problems or at least try to reach an improvement, a model tax treaty for consumption tax purposes is needed. Such a model can be formed by using the international VAT/GST guidelines as a basis. A model tax treaty could serve as a base for both bilateral and multilateral tax treaties. Furthermore, such a treaty would need to include a mutual agreement procedure with the possibility to use an arbitration process. The reason for this is that there is a need for a mechanism at an international level to solve individual cases of double taxation. Even this procedure could be improved by an efficient information exchange system.

*The answer to the overall aim* is thereby that the cross-border consumption taxation of digital supplies in B2C e-commerce is not rational since it creates competitive distortions for suppliers of digital supplies. These distortions are caused by cases of double taxation and unintentional non-taxation. Hence, these need to be combated for reaching a higher degree of rationality.

A re-evaluation of the situation is needed. Which types of supplies should be taxed to create a level playing field? Which types of payment systems should be seen as constituting consideration? These questions could well be part of the work with the VAT/GST guidelines in the OECD as well as be considered by national authorities and the EU. There is a clear need of increasing the level of international co-ordination and co-operation in the area of consumption taxation if the problems with double taxation and unintentional double taxation should be solved.

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<sup>136</sup> See Rendahl, *Cross-Border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-Commerce* (Jönköping International Business School, 2008), section 7.4.3.

The suggested approach is to develop the international GST/VAT guidelines to a model tax treaty for consumption tax purposes. The treaty needs to include a mutual agreement procedure as discussed above. The effects of these measures would increase by a further development of the information exchange between tax authorities in different states. On a more short term basis one suggestion is to improve the interpretative guidelines within the EU and in Australia to cover specific examples covering digital supplies. Such examples already exist in the guidance published by the CRA. The language versions of, particularly, Regulation 1777/2005 need to be improved.