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Notes

Taxation of Global E-Commerce on the Internet: The Underlying Issues and Proposed Plans

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Prologue

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The number of transactions conducted over the Internet has expanded exponentially in the past few years, and countries have become cognizant of the potentially large consequences that "electronic commerce" may have on their important tax revenue bases. As a result, numerous international organizational conferences and intergovernmental meetings have occurred in the past two years dealing with the topic of electronic commerce taxation. Three notable proposals for electronic commerce taxation have emerged from these meetings: the Clinton Administration's "e-card" proposal, the European Community's "VAT" proposal, and the so-called "bit" tax.

This Note examines these three proposals, and argues that the Clinton Administration's e-card proposal should be adopted—with some modifications and additions. Part One of

this Note presents an introduction to the rise of electronic commerce, looks at some basic taxation principles, and also gives a broad overview of the three main electronic commerce tax proposals. Part Two of this Note analyzes the advantages and disadvantages of the three proposed electronic commerce taxing schemes. Finally, Part Three presents a proposal for taxing electronic commerce, utilizing the Clinton Administration's e-card scheme as a template for further discussion.

PART ONE: THE TAXMAN COMETH

I. THE RAPID ASCENDANCE OF GLOBAL ELECTRONIC COMMERCE

A. THE CREATION OF "CYBERSPACE"

Over the past decade, the world's fastest growing commercial center has not been in any specific geographic location.¹ Rather, this growth has occurred in the amorphous, nebulous region of computer communications topography known as Cyberspace² — also commonly referred to as the "Internet,"³ or the "information superhighway."⁴ Created in 1969 by the United States Department of Defense Advanced Research Projects Agency,⁵ the original Internet was quickly adapted for academic use in the 1980s.⁶ In the mid-1990s, the creation of the "World

1. See James D. Cigler, Harry C. Burritt, and Susan E. Stinnett, *Cyberspace: The Final Frontier For International Tax Concepts?*, 7 J. INT'L TAX'N 340, 340 (1996).

2. See Cigler, *supra* note 1, at 340. See also Ian C. Ballon, *Linking, Framing and Other Hot Topics in Internet Law and Litigation*, 520 PLI/Pat 167, 175 (1998) (indicating the term "cyberspace" was coined by author William Gibson in early 1980s; Gibson foretold a world of "virtual reality," generated by computers in which people could interact, conduct business, and entertain themselves); David S. Prebut, *State and Local Taxation of Electronic Commerce: The Forging of Cyberspace Tax Policy*, 24 RUTGERS COMPUTER & TECH. L.J. 345, 346 (1998) (stating the Internet is shorthand for "interconnected networks," an international aggregation of computers and communication networks).

3. See Prebut, *supra* note 2, at 346 (noting that the term "Internet" is shorthand for "interconnected networks," an international aggregation of computers and communication networks).

4. See Howard E. Abrams & Richard L. Doernberg, *How Electronic Commerce Works*, 13 STATE TAX NOTES 123, 123 (1997) ("[I]nformation superhighway refers to the 'interconnected series of networks that provides the infrastructure for transporting information throughout the world.'") (*quoted in* Prebut, *supra* note 2, at 345).

5. See Prebut, *supra* note 2, at 347.

6. See *id.* at 348-49.

Wide Web" ("Web")⁷ and improvements in telecommunications technology spurred commercial application of Internet technology.⁸ Such technologies have enabled the Internet to handle virtually any form of digital information—including text, sound, graphics and video.⁹ As a result, businesses can now use the Internet to reach millions of people around the world,¹⁰ and the pace of commerce conducted electronically has grown dramatically.¹¹

According to the Organization for Economic Co-operation and Development (OECD), the level of electronic commerce (hereinafter, "e-commerce") is expected to grow from a current \$US 26 billion a year to a staggering \$US1 trillion within the next seven years.¹² In the United States alone, electronic commerce sales are estimated to reach \$US 300 billion by the year 2002.¹³ The projected explosive growth of e-commerce has prompted President Clinton to deem the Internet the "Wild West" of the global economy.¹⁴ Similarly, financial commentators have likened current e-commerce participation to a "modern day gold rush . . . as businesses rush to seek their fortunes with the software equivalents of shovels, picks, and pans."¹⁵

One of the main reasons for e-commerce's booming popularity has been its potential beneficial effects on business' bottom

7. See *id.* See also Neal Friedman, *The Legal Challenge of the Global Information Infrastructure*, 2 No.10 CYBERSPACE LAW. 8 (1998) (providing a general history of the Internet).

8. See Cigler, *supra* note 1, at 340. See R. Scot Grierson, *State Taxation of the Information Superhighway: A Proposal for Taxation of Information Services*, 16 LOY. L.A. ENT. L.J. 603, 608 ("[E]xplosive growth in technology is the primary engine for the expansion of commerce over the information highway.").

9. See Cigler, *supra* note 1, at 340.

10. See *id.* See also Mai-Tram B. Dinh, *The U.S. Encryption Export Policy: Taking the Byte out of the Debate*, 7 MINN. J. GLOBAL TRADE 375, 377 (1998) (explaining how the Internet is creating great opportunities for small and large businesses around the globe).

11. See Helene Zampetakis, *E-commerce Tax Major Challenge*, AUSTL. FIN. REV., Sept. 30, 1998, at 30 (indicating experts on global commerce estimate that e-commerce will grow tenfold globally from 1998 to 1999).

12. See Heather Scoffield, *E-commerce Expected to Explode, OECD Says*, THE GLOBE AND MAIL, Sept. 29, 1998, at B6.

13. See Glasser LegalWorks, *Electronic Commerce Update*, 3 No. 3 CYBER-SPACE LAW. 25, May, 1998 (quoting remarks made by President Clinton at the Technology 98 Conference in San Francisco).

14. See *Information Technology: Administration to Negotiate in WTO for Internet Trade Free of Barriers*, 14 INT'L TRADE REP. (BNA) No. 28, at 1178 (July 9, 1997).

15. Craig W. Harding, *Selected Issues in Electronic Commerce: New Technologies and Legal Paradigms*, 491 PLI/Pat 7, 7 (1997).

lines.¹⁶ By conducting transactions over the Internet, businesses have the potential to significantly improve market efficiencies by eliminating middlepersons, and allowing for better management of supplies, production, and distribution.¹⁷ Consequently, the OECD states, "it is clear that accepted ways of doing business will be profoundly modified: traditional intermediaries will be replaced, new products and markets will be created, new and more direct relationships will be forged between businesses and customers."¹⁸

B. DEFINING "E-COMMERCE" MORE PRECISELY

The United Nations Commission on International Trade Law (UNCITRAL) has defined electronic commerce as "commercial activities conducted through an exchange of information generated, stored, or communicated by electronic, optical, or analogous means. . ."¹⁹ More specifically, electronic commerce has become an umbrella term for telecommunications activities conducted over open computer networks, such as the Internet.²⁰ Such activities may include electronic data interchange (EDI), on line retailing, and electronic financial services (such as home banking, electronic funds transfer (EFT), payment processing, and business process reengineering).²¹ To date, the World

16. See Douglas Lavin, *Outlook: Why E-commerce and the Euro Will Pack a Punch*, Wall St. J. Europe, Sept. 7, 1998, at 18.

17. See *id.*

18. OECD, *Dismantling the Barriers to Global Electronic Commerce, Background Paper for Turku Conference*, 1 (October, 1997). In addition to affecting commercial life in profound ways, the OECD also see electronic commerce as having "potentially far-reaching economic and social implications for many facets of life, including, the nature of work, the role of governments, and even the environment." *Id.*

19. Richard Hill and Ian Walden, *The Draft UNCITRAL Model Law for Electronic Commerce: Issues and Solutions*, 13 No. 3 COMPUTER LAW 18, 18 (March 1996).

20. See OECD, *OECD Policy Brief No. 1-1997* (from <http://www.oecd.org/publications/Pol_brief9701_pol.htm>). The OECD has defined the term, "electronic commerce," as referring generally to "commercial transactions, involving both organizations and individuals, that are based upon the processing and transmission of digitized data, including text, sound and visual images and that are carried out over open networks (like the Internet) or closed networks (like AOL or Minitel) that have a gateway onto an open network." *Id.*

21. See Craig W. Harding, *Selected Issues in Electronic Commerce: New Technologies and Legal Paradigms*, 491 PLI/Pat 7, 10 Sept., 1997. See also Kyrie E. Thorpe, *International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?*, 11 EMORY INT'L LAW REV. 633, 647-649 (1997) (stating that the most prevalent classes of sales and transactions which take place on the Internet are: retailing and

Trade Organization (WTO) has not promulgated a formal definition of the term "electronic commerce," but trade diplomats say the term is understood to generally mean transmissions involving electronic information sent over the Internet or other means of telecommunications.²² Some examples of products currently being sold over the Internet include:

- 1.) *The retailing and wholesaling of physical goods:* retailers and wholesalers may use the Internet to supplement or replace paper catalogs and advertisements.²³ This category of electronic commerce is most akin to traditional business methods.
- 2.) *Computer software and online database information:* Customers may access web sites to purchase downloadable software or access electronic research databases.²⁴
- 3.) *Digitized information:* customers may access web sites and rent or purchase images in digital form that are transmitted over the Internet.²⁵
- 4.) *Financial services:* clients may use the Internet to trade stocks and purchase securities²⁶ or to access a "cyberbank" and do remote on-line banking.²⁷

Currently, the business to business segment of e-commerce activity accounts for eighty percent of all e-commerce, and it is likely to spur the most Internet sales growth in the next five to ten years.²⁸ Significantly, it is American companies that dominate the e-commerce landscape—with an estimated eighty percent of all global e-commerce sales coming from the United States.²⁹ Many people with knowledge of the Internet feel that the most innovative, paradigm-shifting Web sites are American.³⁰ As a result of their dominance, American companies are increasingly looking to expand their e-commerce presence glob-

wholesaling, computer software, photographs, online information, services, health care, electronic gambling, and stock trading/purchase of securities).

22. See Daniel Pruzin, International Trade Reporter, *Information Technology: WTO Ministers Reach Deal on Electronic Commerce*, 15 INT'L TRADE REP. (BNA) No. 20, at 886 (May 20, 1998).

23. See Thorpe, *supra* note 21, at 647.

24. See *id.* at 648.

25. See *id.*

26. See *id.* at 649.

27. See P. Michael Nugent, *Cross-Border Transmission of Financial Information: The Cyberbanking Concerns*, 15 No. 5 BANKING POL'Y REP. 31, 31 (1996).

28. See Kimberly Strassel, *Internet's Relative Economic Impact is Played Down in Report by OECD*, WALL ST. J. EUROPE, Sept. 28, 1998, at B9H.

29. See *id.*

30. See Lavin, *supra* note 16 (giving examples of revolutionary American Web sites which include the online bookstore, Amazon.com, and auto sales and electronic brokerage sites).

ally, where the American firms can use their economies of scale to capture a new class of customers.³¹

C. THE "OFFICIAL" RESPONSE TO THE RISE OF E-COMMERCE

The global and amorphous nature of cyberspace puts regulation of the Internet out of the purview of any single government.³² However, because electronic commerce transactions are more likely to cross international borders than non-e-commerce transactions,³³ e-commerce activities may be subject to a morass of conflicting national and local laws and regulations.³⁴ The current regulatory environment inhibits the ability of the Internet to move e-commerce transactions around the globe in the most efficient and optimal manner.³⁵ As long as the current regulatory environment for e-commerce exists, many companies will be unwilling to expand their presence on the Internet, for fear of uncertain and unpredictable costs.³⁶ Specifically, two thorny problems plague the current e-commerce regulatory regime: vagueness and complexity.³⁷ Since e-commerce is a new mode of

31. See W. Scott Blackmer, *Going Global with Electronic Commerce*, 1 ELEC. BANKING L. & COM REP. 1 (1997). See also Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce* (1996) at 8 ("[T]he growth of electronic commerce will be driven in part by the fact that the present [U.S.] economy's important products are software and recorded entertainment (both films and music) which are particularly well suited to being distributed through computer networks.").

32. See Friedman, *supra* note 7.

33. See Blackmer, *supra* note 31.

34. See *id.*

35. See Friedman, *supra* note 7.

36. See *id.*

37. See Steven R. Salbu, *Who Should Govern the Internet?: Monitoring and Supporting a New Frontier*, 11 HARV. J.L. & TECH. 429, 461 (1998). Salbu concludes that a "truly global," unified regulatory approach is best suited to solve the ever-expanding nature of the Internet. See *id.* at 452. See also Michael A. Geist, *The Reality of Bytes: Regulating Economic Activity in the Age of the Internet*, 73 WASH. L. REV. 521, 554-55 (1998). Interestingly, Geist reverses the issue by asking how an increased reliance on the Internet for conducting business activity will impact economic regulation itself. Geist sees the Internet affecting economic regulation in four major areas: the Internet as "medium," the Internet as "catalyst," the Internet as "change," and the Internet as "administration." Geist concludes that the Internet will have profound effects on economic regulation, and, because of the Internet's wide-reaching effect on economic activity, no one single regulatory solution will suffice. See *id.* But see Scott F. Bain, *Examining Traditional Legal Paradigms in a Non-physical Environment: Need We Invent New Rules for the Road for the Information Superhighway?*, 12 BERKELEY TECH L.J. 231, 233-4 (1997) (citing Professor Henry H. Peritt, who contends that existing legal principles can be adapted to the regulation of new technologies, such as the Internet. What is needed, says Peritt, is an understanding of the core legal principles posed by the new technology, and

conducting business transactions, laws governing e-commerce activity are themselves new or nonexistent.³⁸ As a result, jurisprudential interpretation is nascent and undeveloped—and vagueness rules.³⁹ Further complicating the matter are multiple laws which may be conflicting or irreconcilable.⁴⁰ Such vagueness and complexity leads to undesirable economic costs for companies doing business on the Internet.⁴¹ For example, when laws are vague and complex, the need for lawyers increases, along with concomitant increased legal expenses.⁴²

Governments and other agencies have begun to recognize the growing urgency of these problems, and have produced a number of studies over the course of the past year, the most significant of these are discussed below. In this vein, the OECD has posited that:

The emergence of electronic commerce heralds a major structural change in the economies of the OECD member countries. It will affect the economic environment, the organisation of firms, the behaviour of consumers, the workings of government and most spheres of activity of households and citizens. . . [s]overeign nations will need to come to terms with the global and transfrontier nature of new networks and communications systems and establish a coherent, predictable, legal and regulatory framework in which global electronic commerce can flourish . . .⁴³

Following are brief synopses of recent responses from key global players in the area of electronic commerce regulation: the United States, the European Union, the OECD, and the WTO. Generally, these responses state two common themes: (1) the need for a recognizable general governmental policy on e-commerce, and (2) the importance of the development of specific e-commerce tax policies. It is also interesting to note how the responses *differ*—the United States is generally more concerned

a corresponding adaptation of existing legal principles); Jane Kaufmann Winn, *Open Systems, Free Markets, and Regulation of Internet Commerce*, 72 TUL. L. REV. 1177 (1998) (arguing that a skeptical attitude should inform the decision of whether to implement Internet-specific regulation, particularly laws designed to regulate Internet "public key cryptography," technology which authenticates online "signatures." Winn fears that Internet technology manufacturers will receive preferential treatment with respect to the implementation of new regulations—at the expense of consumers).

38. See Salbu, *supra* note 37, at 461.

39. See *id.*

40. See *id.*

41. See *id.*

42. See *id.*

43. OECD, *The Emergence of Electronic Commerce* (last modified Aug. 7, 1998) <http://www.oecd.org/subject/electronic_commerce/documents/emergence.htm>.

with companies' unfettered access to free market flows on the Internet, while the E.U. is highly sensitized to the issue of data privacy, especially in regards to e-commerce consumers.

1. The US response:

In July, 1997, the Clinton Administration issued an inter-agency report entitled, "A Framework for Global Electronic Commerce."⁴⁴ The report cites the increasing economic importance of e-commerce,⁴⁵ and states that the Administration's main task with respect to the promotion of e-commerce is to help create an environment that "facilitates the emergence of a transparent and predictable legal environment to support global business and commerce."⁴⁶ With this objective in mind, the Framework establishes five broad guidelines for the encouragement of e-commerce: (1) e-commerce is best served by industry self-regulation and a minimum of government regulation, (2) governments should avoid imposing undue restrictions on e-commerce, (3) governments should support and enforce a simple, predictable, and consistent legal environment for e-commerce, (4) regulators should recognize the uniquely decentralized and bottom-up leadership characteristics of the Internet, and (5) regulators should adopt the principle of facilitating global commerce.⁴⁷ Additionally, in recognizing the significance of taxation in the development of an overall e-commerce policy, the Framework states that there should be no undue tax burdens on Internet commerce, and also calls for no new taxes on e-commerce.⁴⁸

44. The Clinton Administration, *A Framework for Global Electronic Commerce* (1997).

45. *See id.* at 1. The Framework states that, "Internet technology is having a profound effect on the global trade in services. . .[world trade involving e-commerce] has grown rapidly in the past decade, now accounting for well over \$40billion of U.S. exports alone." *Id.*

46. *Id.* *See also* The White House Office of the Press Secretary, *Presidential Message, July 1, 1997*. President Clinton contends that government officials should adopt a "market-oriented" approach to the regulation of electronic commerce, in order that e-commerce can "grow and flourish." *See id.*

47. *See* The Clinton Administration, *supra* note 44.

48. *See id.* at 3-4. Aside from stating that no new taxes should be imposed on Internet commerce, the Framework also argues that any taxation of e-commerce should follow these general principles: any e-commerce taxes should not discriminate among types of commerce; tax systems should be simple and transparent; and the system should accommodate existing national taxing schemes. *Id.* at 4. Further exposition of the tax concepts underlying these principles follows below.

Prior to the Clinton Administration's *Framework*, the U.S. Treasury Department released a study on e-commerce taxation⁴⁹ which observed that:

[N]ew technologies, particularly communications technologies including the Internet, have effectively eliminated national borders on the information highway. As a result, cross-border transactions may run the risk that countries will claim inconsistent taxing jurisdictions, and that taxpayers will be subject to quixotic taxation.⁵⁰

In addition to the tax jurisdiction problem, the Treasury Department cites "tax neutrality," "classification of income," and "tax administration and compliance" as significant "transnational" tax issues deserving prompt attention.⁵¹ These issues are further discussed later in this note.

Thus, the United States' overall objective, vis a vis e-commerce, is the expansion of e-commerce activity. Consequently, the United States desires open e-commerce markets—with minimal governmental regulations and minimized tax burdens.

2. *The European Union's response:*

The European Commission's "Initiative In Electronic Commerce" was released in the spring of 1997⁵² amidst concerns that the "rapid implementation" of e-commerce poses an "enormous challenge for commerce, industry and governments in Europe."⁵³ One of these challenges, the Initiative states, is that "Europe's main competitors have already resolutely seized opportunities offered by electronic commerce—with the US building a substantial lead."⁵⁴

49. See Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce* (1996). For a discussion of the Treasury's paper, see James D. Cigler and Susan Stinnett, *Treasury Seeks Cybertax Answers with Electronic Commerce Discussion Paper*, 8 J. INT'L TAX'N 56 (1997). See also Pillsbury, Madison & Sutra LLP, *U.S. Treasury Office of Tax Policy: Selected Tax Policy Implications for Global Electronic Commerce* (visited October 2, 1998) <<http://www.pmstax.com/intl/ustdnet9611.html>> (commenting on the Treasury Department's paper).

50. See Department of the Treasury, *supra* note 49, at 3.

51. See *Id.* at 3-4. In light of the increasing importance of e-commerce, the Treasury Department also boldly calls for a reexamination of the Internal Revenue Code and "generally accepted principles of international tax policy." See *id.* at 10.

52. European Commission, *A European Initiative in Electronic Commerce*, available at <<http://www.cordis.lu/esprit/src/ecomcomx.htm>> (last modified April 16, 1997). See also Aspen Law & Business, *European Union Considers Regulatory Framework for Electronic Commerce*, 16 No. 12 BANKING POL'Y REP. 10, 10 (1997).

53. European Commission, *supra* note 52.

54. *Id.*

The Initiative pronounces that the EC's first objective with respect to e-commerce is to provide a regulatory environment that can "build trust and confidence"—primarily by addressing the issue of data privacy for consumers and businesses.⁵⁵ The report states that e-commerce cannot develop unless consumers and businesses are confident that their transactions will not be intercepted or modified, and that the transactions are "available, legal and secure."⁵⁶

The E.U. Initiative also calls for: (1) consistent and workable regulations in the areas of contracts and e-payments,⁵⁷ (2) progress towards a global regulatory framework,⁵⁸ and (3) the assurance of a "clear and neutral" tax environment.⁵⁹ Specifically, the Initiative advocates an e-commerce tax system that provides for "legal certainty" and "tax neutrality."⁶⁰ While the E.U. and the United States share similar ideas regarding e-commerce regulation, the E.U. appears less concerned about a minimal regulation (e.g., low tax burden), open market e-commerce environment than does the United States. Though the E.U. is cognizant of the American lead in e-commerce activity, the E.U.'s desire to catch up to the U.S. appears tempered by a strong emphasis on data privacy.

3. *The WTO's response:*

The WTO has been very active in studying the issue of e-commerce regulation,⁶¹ and plans to play a central role in global

55. See *id.* See also Mark E. Budnitz, *Privacy Protection for Consumer Transactions in Electronic Commerce: Why Self-Regulation is Inadequate*, 49 S.C. L. Rev. 847 (1998) (providing reasons why consumers are wary of conducting transactions on the Internet).

56. European Commission, *supra* note 52.

57. See *id.*

58. See *id.* at 13-14.

59. See *id.*

60. See *id.*

61. See World Trade Organization, *Study From WTO Secretariat Highlights Potential Trade Gains from Electronic Commerce*, March 13, 1999 (commenting on a WTO Secretariat study highlighting the growing significance of e-commerce). See, e.g., INT'L TRADE REP. (BNA), *supra* note 14. In addition to the WTO e-commerce report cited herein, the WTO convened a "draft work program" in July, 1998 on e-commerce. Six subordinate bodies will report back to the General Council by the end of June, 1999, in time to issue recommendations for member action during the third WTO ministerial to take place at the end of 1999. See generally *Information Technology: WTO Council Chair Puts Forth Draft Work Program for Electronic Commerce*, 15 INT'L TRADE REP. (BNA) No. 29, at 1307 (July 29, 1998).

e-commerce regulation.⁶² A March, 1998 WTO report cited the following as key issues deserving "further consideration":⁶³ (1) the establishment of global telecommunications infrastructure standards, (2) a predictable legal and regulatory structure for enforcing legal rights, (3) content regulation laws, and (4) a predictable framework for taxation and financial regulation. The WTO acknowledges that because taxation of e-commerce will be one of the most delicate areas for negotiations (because of multi-jurisdiction and other issues),⁶⁴ further research needs to be conducted in the areas of double taxation, tax jurisdiction, and currently proposed taxing schemes such as the "bit tax" and "VAT tax."⁶⁵ In keeping with its role as overseer and arbiter of international trade, the WTO is particularly concerned with e-commerce's impact on developing countries.⁶⁶ With the other e-

62. See Winston J. Maxwell and Thomas P. Newman, *Electronic Commerce Considered By World Trade Organization: Comprehensive Regulatory Review Begun*, N.Y. L.J., November 16, 1998 at S7. Because of the multidimensional nature of e-commerce, the WTO expects to play a central role in its regulation and become the "pre-eminent body" in the international regulation of e-commerce. Furthermore, the WTO expects a "wide scope of competence" for its role in regulating e-commerce, expecting e-commerce issues to touch not only upon traditional GATT (General Agreement on Tariffs and Trade) and GATS (General Agreement on Trade in Services) areas, but also multilateral agreements—especially those touching upon intellectual property, telecommunications, and government procurement. *Id.*

63. See 15 INT'L TRADE REP. (BNA) No. 29, *supra* note 61, at 1307.

64. See *Information Technology: WTO Report Charts E-Commerce Issues, Sees Key Role For Government Regulators*, 15 INT'L TRADE REP. (BNA) No. 12, at 526 (March 25, 1998).

65. *See id.*

66. *See id.* Developing countries fear that their overall bargaining power with respect to trade may diminish, as developed countries further develop their e-commerce capabilities—thus leading to an even greater disparity between the haves and have-nots. *Id.* Developing countries also worry that e-commerce will cause them to be more consumers rather than producers, further exacerbating current balance of payment problems with their wealthier counterparts. *Id.* From a taxation standpoint, then, developing countries would rather see an e-commerce taxing regime that favors the collection of taxes from the consumer rather than seller. Developing countries would consequently see less erosion of their tax bases under such a tax regime. *See also* John K. Sweet, *Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles*, 146 U. PA. L. REV. 1949, 1996-97 (1998) (examining the possible unfairness to developing countries of implementing the U.S. Treasury Department's e-commerce tax proposals, because of the income loss to those countries if the Treasury Department's plan is implemented). Sweet recommends the use of multilateral tax treaties as a partial remedy—the development of a "tax treaty network." *Id.* at 2003-06. Such a network would provide greater information to both developed and developing countries as to the global flow of e-commerce tax monies, and treaties could provide an opportunity for

commerce issues, however, the WTO appears currently to be taking a detached posture, only suggesting areas of concern for further consideration and study, waiting for member countries to develop their own policy responses before taking any firm positions of its own.⁶⁷

4. The OECD's response

The OECD released a background paper in October, 1997, suggesting a set of key areas for governments to ponder in the development of national policies on e-commerce.⁶⁸ Among other issues addressed in the study, the OECD sees the need for governments to address the following: (1) easing barriers to electronic commerce to achieve a balance between self-regulation and a legal framework,⁶⁹ (2) building user and consumer trust—with e-commerce regulations that boost confidence by providing

redress of the erosion of developing countries' tax bases. *Id.* See generally Department of the Treasury, *Selected Tax Implications of Global Electronic Commerce*, 18, (1996) ("[The] United States currently has comprehensive income tax treaties with 48 countries. The rules embodied in these tax treaties generally give the residence country an unlimited right to tax income while limiting or eliminating the source country's right to tax."); David R. Tillinghast, *Tax Treaty Issues*, 50 U. MIAMI L. REV. 455, 455-56 (1996) (claiming that the United States' income tax treaties with other nations are "endangered," because of new economic developments that are shifting the economy away from the traditional industrial economy, and blurring previously discrete tax categories). But see OECD, *Electronic Commerce: A Discussion Paper on Taxation Issues* (1998). The Committee on Fiscal Affairs of the OECD feels, contrary to some commentators, that, "the principles which underlie the international norms that it has developed in the area of tax treaties. . . are capable of being applied to electronic commerce. . ." *Id.* at 22; Charles M. McLure, Jr., *U.S. Tax Laws and Capital Flight from Latin America*, 20 U. MIAMI INTER-AM. L. REV. 321, 321,356 (1989) (McLure, a Senior Fellow at Stanford University's Hoover Institution, feels that the failure of developing countries—such as those in Latin America—to tax foreign source income has been a direct loss of revenue and capital that could have otherwise been used for "productive investment" at home, and that, consequently, developing countries can reverse this "flight of capital" only by insisting "en masse" that current global tax policies are unsatisfactory).

67. See WTO, *supra* note 61, at 1.

68. See OECD, *Dismantling the Barriers to Global Electronic Commerce, Background Paper for Turku Conference* (October, 1997). See also *Electronic Commerce: OECD Releases E-commerce Blueprint; Will Hold Crypto Talks with Non-members*, INT'L TRADE DAILY (BNA) (May 30, 1997), available in Westlaw, BNA-BTD Database. In this earlier "blueprint," the OECD suggests that governments take action on three broad fronts: (1) supporting opportunities for the growth of e-commerce, (2) raising the visibility of e-commerce, and (3) defining new principles for the governance of economic activity in cyberspace.

69. See OECD, *supra* note 68, at 3. The OECD suggests that any new regulation must allow consumers to have sufficient access to and use of e-commerce infrastructure (e.g., computers, servers, software, as well as the communications modes themselves (e.g., cable TV, cellular mobile networks, broadcasting

greater user security and data privacy,⁷⁰ (3) providing for consumer protection—especially with respect to fraudulent advertising or other illicit business practices by e-commerce merchants,⁷¹ (4) minimizing regulatory uncertainty by a harmonization of national e-commerce policies,⁷² (5) resolving intellectual property issues,⁷³ and (6) the need for the resolution of multiple e-commerce taxation issues.⁷⁴ The OECD has also stressed the requirement for a consistent national approach to developing e-commerce regulations,⁷⁵ and sees both the public and private sectors playing an important role in the development of new e-commerce regulations.⁷⁶

In regards to taxation, the OECD has stated that it sees “neutrality” as being the “guiding principle for the taxation of electronic commerce.”⁷⁷ However, the OECD has also stated that it views taxation, of all the barriers, as being perhaps the

networks)), and that also encourages economic competition among e-commerce companies. *Id.* at 3-6.

70. See *id.* at 6-11. The OECD cites the “digital nature of electronic commerce” as allowing for the potential for “extensive international damage in a short time.” *Id.* at 8. Thus, the OECD recommends further investigation into the need for regulations requiring the use of cryptography, certification, encryption and other security-enhancing and data verifying technologies, in order to build greater business and consumer trust in electronic transactions. *Id.* at 6-11. Examples given of the possible “damage” that can befall e-commerce users are the potential for the pilfering of electronic signatures, as well as the illicit “mining” and use of private personal data. *Id.*

71. See *id.* at 12-14. The OECD sees the international and multi-jurisdictional nature of the Internet as a potential source for abuse of consumers by e-commerce vendors. *Id.* The OECD suggests that financial intermediaries and new technologies have a vital role to play in solving the issue. *Id.*

72. See *id.* at 15.

73. See *id.* at 18. The OECD states that the resolution of intellectual property issues are crucial to the development of e-commerce. *Id.* (For instance, should e-commerce transactions be governed by existing WIPO and WTO TRIPS agreements?). *Id.*

74. See *id.* at 15. The OECD sees source, residency, permanent establishment (concepts that affect tax jurisdiction), and characterization of income as being primary e-commerce tax issues that need to be solved. *Id.*

75. See *Electronic Commerce: OECD to Prepare for International Approach in Developing Online Commerce*, INT'L TRADE DAILY (BNA) (Nov. 5, 1997), available in Westlaw, BNA-BTD Database.

76. See *Electronic Commerce: Cooperation Accepted as Best Way Forward; OECD to Draw up Tax, Protection Guidelines*, INT'L TRADE DAILY (BNA) (Nov. 24, 1997), available in Westlaw, BNA-BTD Database.

77. See OECD, *Developing the Taxation “Rules of the Road” for the Information Highway* (visited September 20, 1998) <http://www.oecd.org/daf/fa/e_com/e_comm.HTM>. The principle of “neutrality” is discussed *infra*.

most difficult to overcome in terms of expanding e-commerce,⁷⁸ in part due to the multi-jurisdictional aspects of taxation.⁷⁹

II. GENERAL TAX PRINCIPLES RELEVANT TO E-COMMERCE TAXATION

A. THE PRINCIPLE OF "TAX NEUTRALITY"

The principle of tax neutrality requires that any equitable tax system treat economically similar income equally.⁸⁰ For electronic commerce to flourish, the principle of tax neutrality, as applied to e-commerce, would require that income earned through electronic means should be taxed similarly to income earned through more conventional channels of commerce.⁸¹ To do otherwise would be to place e-commerce at a competitive disadvantage relative to other modes of commerce, defeating one of the purposes of an equitable tax system.⁸² The practical application of tax neutrality, then, would be a position that no "new" taxes should be placed on e-commerce transactions.⁸³

78. See Kimberly A. Strassel and Jennifer L. Schenker, *OECD Summit to Focus on Internet-Tax Collection*, WALL ST. J. EUROPE, Sept. 15, 1998, at 8.

79. See OECD, *supra* note 68, at 15.

80. See James D. Cigler and Susan E. Stinnett, *Treasury Seeks Cybertax Answers with Electronic Commerce Discussion Paper*, 8 J. INT'L TAX'N 56, 58 (1997).

81. See Sandi Owen, *State Sales & Use Tax on Internet Transactions*, 51 FED. COMM. L.J. 245, 258 (1998) ("[U]nder the principle of tax neutrality, goods and services provided in electronic commerce should be taxed no differently from goods and services provided in conventional commerce."). See also John Kennedy, *Taxing the Net: The European Union is Keen to Implement a Framework for Applying VAT on Internet Transactions*, BUSINESS AND FINANCE, October 22, 1998; The Harvard Legislative Research Bureau, *Remote Purchasing and Fundamental Fairness: The Sales and Use Tax Equalization Act*, 35 HARVARD J. LEGIS. 537, 537-39 (1998) ("[T]he principle of neutrality... requires that tax considerations not affect consumer choices."). The Harvard Legislative Bureau examines the issue of tax neutrality, vis a vis e-commerce, from a different perspective, and argues that equity requires that consumers not have an incentive to purchase from the Internet simply because of the ability to save taxes. *Id.* at 539.

82. See *id.*

83. See *id.* See also the Clinton Administration, *A Global Framework for Electronic Commerce* (1998). The Clinton Administration argues that no new taxes should be created to specifically tax e-commerce, since existing tax regimes should accommodate this new mode of economic activity. *Id.* at 4. The OECD also agrees that no new taxes should be created for e-commerce transactions. See OECD, *Electronic Commerce: A Discussion Paper on Taxation Issues* (1998). The OECD states that different treatment for e-commerce transactions would be misguided, since e-commerce is not a new type of business or product, it is simply a "new mode of production, marketing, distribution, payment, etc." *Id.* at 25.

B. THE "PERMANENT ESTABLISHMENT" CONCEPT

Article 5 of the OECD of the Model Income Tax Convention, defines a permanent establishment as ". . . a fixed business place of business through which the business of an enterprise is wholly or partly carried on."⁸⁴ Article 5 also provides that a permanent establishment may be created in a country by means of an agent, broker, or general commission agent.⁸⁵ Permanent establishment is a key tax concept because, under most tax treaties, a business must be determined to have a permanent establishment presence in that country before the country can attempt to tax the profits of the business.⁸⁶ As the OECD has stated, "tax conventions generally provide that business profits of non-residents may only be taxed in a country to the extent that they are attributable to a permanent establishment that the enterprise has in that country."⁸⁷

C. "SOURCE" AND "RESIDENCE" BASED TAXATION PRINCIPLES

Countries impose taxes on companies based on both the source and residence principles.⁸⁸ In general, if it is established that a company is a "resident" of a country, that country may fix a legal right to tax that company's income.⁸⁹ The concept of residency is grounded in the permanent establishment principle,⁹⁰

84. See The 1992 OECD Model Income Tax Convention on Income and Capital, Article 5. See also Cigler, Burritt, and Stennett, *supra* note 1.

85. *See id.*

86. *See id.* See also Department of Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, 20 (1996) ("[I]t has come to be accepted in international fiscal matters that until an enterprise of one State sets up a permanent establishment in another State it should not properly be regarded as participating in the economic life of that other State to such an extent that it comes within the jurisdiction of that other State's taxing rights.").

87. See OECD, *Electronic Commerce: A Discussion Paper on Taxation Issues* (1998). The OECD raises the issue of whether a website or other e-commerce presence in a country may qualify as a "permanent establishment." *Id.* at 24. The OECD also acknowledges, however, that the concept of permanent establishment may be "ill-adapted" to e-commerce. *Id.* The consequences are profound, for the taxation of e-commerce may mean that many bilateral and multilateral tax treaties may have to be amended or scrapped in order to accommodate international e-commerce taxation regimes (since most tax treaties require some sort of permanent establishment presence before a country may tax a business).

88. See Cigler and Stinnett, *supra* note 80, at 59.

89. See William C. Benjamin and Michael J. Nathanson, *Conducting Business Using the Internet: Gauging the Threat of Foreign Taxation*, 9 J. INT'L TAX'N 29, 30 (1998).

90. See Thorpe, *supra* note 23, at 655.

and residency requirements are usually tied to some geographic or physical presence in the country.⁹¹

If a company fails to establish a residency in a country, the country may still impose taxes on the company's income if it is determined that the "source" of the company's income was derived from within the country's borders.⁹² Most countries provide that the source of a company's income is the country in which the economic activities generating the income occur.⁹³

Source of income principles generally have priority over residency rules,⁹⁴ and the country of origin usually has the right to tax income.⁹⁵ Double taxation is avoided by a credit or exemption system provided by the residence country.⁹⁶ Such rules have been adopted by most taxing authorities worldwide.⁹⁷

III. TAXATION OF E-COMMERCE: THE KEY UNDERLYING ISSUES

A. A POTENTIALLY DECREASING TAX BASE

1. *Displaced income*

According to Arthur Cordell, of the Canadian Department of Industry, the "new wealth of nations" is to be found in the digital bits of information "pulsing through global networks."⁹⁸ The in-

91. See Benjamin and Nathanson, *supra* note 89, at 30.

92. *See id.*

93. See The Department of Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, 18, (1996). The Treasury Department gives examples applying source-based rules: (1) income derived from use of intellectual property has its source in the location where the intellectual property is utilized, and (2) compensation for labor or personal services has as its source where the labor or personal services were used. *Id.*

94. *See id.* *See also* Benjamin and Nathanson, *supra* note 89, at 30.

95. See Department of Treasury, *supra* note 93. *See also* Cigler and Stinnett, *supra* note 80, at 59.

96. See Department of Treasury, *supra* note 93.

97. *See* Cigler and Stinnett, *supra* note 80, at 59.

98. See Arthur J. Cordell, *New Taxes for a New Economy* (visited October 3, 1998) <<http://www.usask.ca/library/giv/v2n4/cordell/cordell.html>> (originally presented September 14, 1995 at Victoria University in University of Toronto, before the World Leadership Conference). *See also* Arthur J. Cordell, *Taxing the Internet: The Proposal for a Bit Tax* (visited March 8, 1999) <<http://www.arraydev.com/commerce/JIBC/9702-05.htm>> (originally presented February 14, 1997 in a speech to the Harvard Law School). Cordell makes the case that, in a "global networked economy," tax revenues are threatened as commercial revenues move to the Internet and are not recaptured by government authorities. *Id.* at 1. Cordell sees the Internet, however, as a vehicle for wealth creation, in a "New Economy," and as an opportunity for governments to widen their tax bases. *Id.* Cordell gives the following as examples of companies that are thriving by transacting on the Internet: E*Trade, an online investing com-

come flows occurring over the Internet are a new and potent source of potential government tax revenue.⁹⁹ However, if the potential tax revenue from this new form of income is not captured, the overall tax base will be eroded by a "double whammy": the total loss of tax revenue not collected, plus the loss of tax revenue from the income of workers displaced by new information technologies.¹⁰⁰ The situation is most acute in Europe, which relies primarily on the "VAT" consumption tax for its tax base.¹⁰¹ The OECD estimates that half a billion European Currency Units will be lost by 2001 if the VAT is not applied to e-commerce transactions.¹⁰²

2. Tax avoidance and compliance issues

A second form of tax base erosion may occur due to the ephemeral nature of global e-commerce transactions.¹⁰³ Such transactions are exceedingly difficult to verify since they leave no physical record and may be conducted with electronic cash.¹⁰⁴ An unfortunate consequence of this new technology, according to the OECD, is that the Internet may become a prime conduit for

pany with annual revenues of 68 million dollars; Amazon.com, an online "book-store" with customers in 66 countries; and PhotoDisc, an online provider of digitized photographic images with 30,000 customers. *Id.* at 3-4.

99. *See id.*

100. *See id.*

101. *See* Strassel and Schenker, *supra* note 78; Christopher Deal, *The GATT and VAT: Whether VAT Exporters Enjoy a Tax Advantage Under the GATT*, 17 LOY. L.A. INT'L & COMP. L.J. 649 (1995). The "VAT" is the "value added tax," a tax on the consumption side levied on goods and services. *Id.* at 650. The VAT is computed by taxing the value added to a good at each stage of production, usually at a flat rate—offsets are available at each stage to prevent double taxation. *Id.* at 650-51. *See also* Alan Schenk, *The Plethora of Consumption Tax Proposals: Putting the Value Added Tax, Flat Tax, Retail Sales Tax, and USA Tax into Perspective*, 33 SAN DIEGO L. REV. 1281, 1290-1294 (1996) (providing a quick history of the use VAT and consumption taxes); Jennifer L. Schenker, *E-commerce in Europe*, WALL ST. J. EUROPE, Sept. 7, 1998.

102. *See* Strassel and Schenker, *supra* note 78.

103. *See* Charles Leadbeater, *The Death of Taxes as We Know Them*, PITTSBURGH POST-GAZETTE, July 26, 1998 at E1.

104. *See id.* *See also* Department of Treasury, *Selected Tax Policy Implications of Global Electronic Commerce* (1996). The Treasury Department sees a potentially increased role for issuers of electronic money in combating tax evasion and avoidance, since the issuers represent the "interface between the physical economy and the electronic economy." *Id.* at 29. *See generally* Harvard Legislative Research Bureau, *Remote Purchasing and Fundamental Fairness: The Sales and Use Tax Equalization Act*, 35 HARVARD J. LEGIS. 537 (1998). The Harvard Legislative Research Bureau presents an alternate, even simpler form of potential tax avoidance on the Internet. *Id.* at 538-39.

business tax avoidance.¹⁰⁵ The OECD posits that if electronic cash is floating around the Internet, the lack of a paper trail would prevent tax authorities from conducting accurate audits.¹⁰⁶

This problem would be especially acute for countries which rely on consumption taxes for tax revenue, such as the "VAT" (value added tax). Since consumption taxes are a tax on sales, any lost taxes on undetected consumption of products conducted over the Internet would mean a proportional loss to the country's tax base.¹⁰⁷ Significantly, the value added tax is the single most important tax raising measure for all OECD countries, except Australia and the United States.¹⁰⁸ In addition to lost income to government coffers, the Harvard Legislative Research Bureau argues that increased tax avoidance "dramatically affects" the fairness of the tax system and distorts economic decision making.¹⁰⁹

105. See *Electronic Commerce: Elusive Nature of Commerce on Internet Requires Uniform Rules, Tax Experts Agree*, INT'L BUSINESS & FINANCE DAILY (BNA) (Feb. 24, 1998), available in LEXIS, BNA-IBFD Database.

106. See *id.*

107. See *Taxes: OECD Report Says VAT Remains Most Important Consumption Tax*, INT'L BUSINESS & FINANCE DAILY (BNA) (Feb. 14, 1997), available in LEXIS, BNA-IBFD Database.

108. See Jennifer L. Schenker, *Why E-Commerce and the Euro Will Pack a Punch: Tax-free Days in Cyberspace Could be Numbered*, WALL ST. J. EUROPE, September 7, 1998.

109. Harvard Legislative Research Bureau, *Remote Purchasing and Fundamental Fairness: The Sales and Use Tax Equalization Act*, 35 HARVARD J. LEGIS. 537, 537-38 (1998). The Bureau argues that differential taxing of goods and services obtained via e-commerce versus other conventional means (e.g., purchasing at a physical store) distorts economic decision making, since, *ceteris paribus*, the consumer will opt for the lower-priced product (after taxes). *Id.* at 538-39. The natural inference from this line of reasoning is that proposed taxes on e-commerce should be neither higher nor lower than existing taxes. If e-commerce taxes are higher relative to conventional means of obtaining goods and services, then e-commerce suffers, as consumers will choose the lower-priced conventionally-obtained product (and *vice versa*). See OECD, *Electronic Commerce: A Discussion Paper on Taxation Issues*, 4 (1998) ([It is] important to avoid an unfair distortion of competition which would result from a de facto double or non-taxation of electronic commerce vis a vis fully taxed 'traditional' commerce carried out via conventional 'physical' means."); Martin J. Moylan, *Online Retailers May Have Tax Advantage*, ST. PAUL PIONEER PRESS, October 31, 1998 at 1E (noting that because e-commerce transactions are currently untaxed, a member of the National Retail Federation decries the competitive advantage that e-commerce retailers such as Amazon.com (an e-commerce bookseller) have over traditional storefront retailers, who have to charge their customers a state sales tax).

B. JURISDICTIONAL ISSUES: PROBLEMS IN DETERMINING
PERMANENT ESTABLISHMENT AND APPLYING SOURCE
BASED TAXATION PRINCIPLES TO E-COMMERCE
TRANSACTIONS

With respect to e-commerce transactions, determining a taxable presence within a country may be a perilous proposition.¹¹⁰ According to the OECD, since Internet servers can be located in multiple global locations, defining them as a fixed place of business could lead to inadvertent double taxation.¹¹¹ The following hypothetical illustrates some of the problems inherent in a common e-commerce transaction:

A customer in Norway uses his computer to access a server located in India to purchase goods produced by a U.S. company. The U.S. company has no other presence in, or contact with, Norway or India. Under these circumstances, which country or countries may tax the U.S. company's business profits on its sale to the Norwegian customer?¹¹²

110. See Thorpe, *supra* note 21, at 655. See also *infra* note 112; John F. Delaney and Adam Lichstein, *The Law of the Internet: A Summary of U.S. Internet Caselaw and Legal Developments*, 505 PRACTICING LAW INSTITUTE 79, 156 (1998). The rise of Internet has also caused thorny problems Stateside in determining traditional personal jurisdiction analysis. Now, courts must consider to what extent "electronic contacts" should count in establishing a person's "minimum contacts" in a particular state. *Id.* See, e.g., *CompuServe Inc. v. Patterson*, 89 F.3d 1257 (6th Cir. 1996), reh'^g, en banc, denied 1996 U.S. App. LEXIS 24796 (6th Cir. Sept. 19, 1996) (*quoted in Law of the Internet* at 157) (where a defendant who had sent e-mail to plaintiff in Ohio was found to have maintained "contacts" in that state). But see, e.g., *Quill v. North Dakota*, 504 U.S. 298 (1992) (*quoted in Peter A. Glicklich, Sanford H. Goldberg, and Howard J. Levine, Internet Sales Pose International Tax Challenges*, 84 J. TAX'N 325, 328-29 (1996)) (where the Court held that North Dakota's enforcement of its use tax on an out-of-state mail order company with no physical presence in the state was an unconstitutional burden on interstate commerce—it appears the ruling could be easily analogized to electronic commerce, since there exists even less physical contact in a typical e-commerce transaction than a mail order one); Matthew G. McLaughlin, *The Internet Tax Freedom Act: Congress Takes a Byte Out of the Net*, 48 CATH. U. L. REV. 209, 223 (1998) (for a discussion of the *Quill* case).

111. See *Taxes: U.S. Says Electronic Commerce Creating Need For Permanent Establishment*, INT'L BUSINESS & FINANCE DAILY (BNA) (Oct. 23, 1998), available in LEXIS, BNA-IBFD Database. See also Diane M. Ring, *Exploring Challenges of Electronic Commerce Taxation Through the Experience of Financial Instruments*, 51 TAX L. REV. 663, 669 (1996) ("[I]f many jurisdictions try to claim a source connection, for example, to Internet sales income, the potential for multiple levels of taxation is especially serious."); Peter A. Glicklich, Sanford H. Goldberg, and Howard J. Levine, *Internet Sales Pose International Tax Challenges*, 84 J. TAX'N 325, 327 (1996) (asserting that the United States must coordinate tax treaty agreements, in order to avoid the problem of double taxation).

112. See Benjamin and Nathanson, *supra* note 89, at 30.

As this example demonstrates, traditional physical presence or agency concepts of permanent establishment are difficult to apply within the realm of cyberspace.¹¹³ Several cogent issues arise. For example, does the presence of the U.S. company's Web site on the Norwegian customer's computer qualify as a permanent establishment in Norway,¹¹⁴ or can it be shown that the location of the U.S. company's server in India qualifies as a permanent establishment?¹¹⁵ Finally, in applying source of income rules, where might one say that most of the economic activity concerning this transaction takes place—in Norway, in India, or in the U.S.? Obviously, there exists the contentious potential for multi-jurisdictional turf battles concerning the right to tax the company's profits in the transaction.¹¹⁶

113. See Thorpe, *supra* note 21, at 655. See also Peter A. Glicklich, Sanford H. Goldberg, and Howard J. Levine, *Internet Sales Pose International Tax Challenges*, 84 J. TAX'N 325, 326 (1996) (arguing that traditional permanent establishment concepts are difficult to apply in an e-commerce context); Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, 20 (1996) ("The concept of a U.S. trade or business was developed in the context of conventional types of commerce, which generally are conducted through identifiable physical locations. Electronic commerce, on the other hand, may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location.").

114. See Benjamin and Nathanson, *supra* note 89, at 31.

115. See *id.*

116. See also The Internet Tax Freedom Act (1998). The Tax Freedom Act provides an interesting perspective on the domestic U.S. handling of, and the response of the U.S. Congress to, the issue of multi-state turf battles over jurisdiction and the states' ability to tax e-commerce transactions involving out-of-state sellers. The Tax Freedom Act places a three year moratorium on states' abilities to tax e-commerce transactions. *Id.*; Matthew G. McLaughlin, *The Internet Tax Freedom Act: Congress Takes a Byte Out of the Net*, 48 CATH. U. L. REV. 209 (1998) (arguing that the federal government has an important role to play in establishing uniform tax laws nationally, in order to forestall the confusion that could be caused by implementation of multiple-commerce taxing schemes by different states); Megan E. Groves, *Where There's a Will, There's a Way: State Sales and Use Taxation of Electronic Commerce*, 74 IND. L.J. 293 (1998) (arguing for Congress to allow states to tax e-commerce transactions); Sandi Owen, *State Sales & Use Tax on Internet Transactions*, 51 FED. COMM. L.J. (1998) (providing different scenarios for how states could collect sales and use taxes on e-commerce transactions without running afoul of the Constitution); Walter Hellerstein, *State and Local Taxation of Electronic Commerce: Reflections on the Emerging Issues*, 52 U. MIAMI L. REV. 691 (1998) (contending that the Supreme Court would probably not hold that states were powerless to tax e-commerce under the Constitution); Edward Morse, *State Taxation of Internet Commerce: Something New Under the Sun?*, 30 CREIGHTON L. REV. 1113 (1997) (arguing that government should tread carefully on the issue of whether states should be allowed to tax e-commerce transactions, due to the possibility of "unduly burdensome" collection responsibilities on Internet sellers); Saba Ashraf, *Virtual Taxation: State Taxation of Internet and On-line Sales*, 24 FLA.

Since commerce in cyberspace transcends national borders and the fixed physical location of transactions, the U.S. Treasury has observed that source-based taxing schemes could be obsolete with respect to e-commerce.¹¹⁷ The Treasury has also indicated that residence-based taxing schemes should apply when the traditional concepts of permanent establishment and source-based taxation do not apply.¹¹⁸ The issue, of course, is whether there can be international coordination of such a regime, given that the great majority of companies conducting business over the Internet are American.¹¹⁹ Creating a regime may be difficult given that application of residence-based principles would mean that the United States would get to keep a large portion of e-commerce derived tax revenue. Additionally, international coordination of tax matters may be problematic, because no area of the law is closer to the subject of sovereignty than taxation,¹²⁰ and countries are generally very reluctant to surrender their autonomy in this area.¹²¹

St. U. L. Rev. 605 (1997) (contending that states do not have constitutionally sound arguments for taxing e-commerce transactions when the seller does not have a physical presence in the state); Gregory A. Ichel, *Internet Sounds Death Knell for Use Taxes: States Continue to Scream Over Lost Revenues*, 27 SETON HALL L. REV. 643 (1997) (stating that Congress must intervene to legislate in the area of state taxation of e-commerce, acknowledging that states are losing vital tax revenue without such federal legislation); R. Scot Grierson, *State Taxation of the Information Superhighway: A Proposal for Taxation of Information Services*, 16 LOY. L.A. L. REV. 603 (1996) (proposing a model federal statute that would enable states to collect taxes on e-commerce transactions constitutionally); David C. Blum, *State and Local Taxing Authorities: Taking More Than Their Fair Share of the Electronic Information Age*, 14 J. MARSHALL J. COMPUTER & INFO. L. 493 (1996) (indicating that state departments of revenue should be precluded from statutory interpretations that allow "predatory gamesmanship" on users and providers of e-commerce).

117. See James D. Cigler and Susan E. Stinnett, *Treasury Seeks Cybertax Answers With Electronic Commerce Discussion Paper*, 8 J. INT'L TAX'N 56, 59 (1997).

118. Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce* (1996). The Treasury Department argues that the growth of new communications technologies "will likely require that principles of residence-based taxation assume even greater importance." *Id.* at 19. This is because it is difficult to apply source of income principles to the world of cyberspace; by contrast, "almost all taxpayers are resident somewhere." *Id.* See also Cigler and Stinnett, *supra* note 117, at 59.

119. See Strassel, *supra* note 28.

120. See H. David Rosenbloom, *Sovereignty and the Regulation of International Business in the Tax Area*, 20 CAN.-U.S. L.J. 267, 267 (1994).

121. See *id.* at 268. Though other legal areas are also sources of friction amongst countries, feelings seem to be more extreme in the area of national taxation. *Id.* Tax attorney Rosenbloom predicts "painful conflict" over the international coordination of tax policies, as technology expands and global eco-

C. THE "GOODS" VS. "SERVICES" VS. "INTANGIBLES" DISTINCTION

A key issue for properly taxing e-commerce transactions is how to categorize certain e-commerce transactions in which the end-product is received on-line (e.g., software, online information services, digitized images, and film and video output).¹²² According to the OECD, many goods once sold in physical format are now available on-line.¹²³ Classification issues are critical because of the possibility of a differential tax impact, both under United States and E.U. tax laws.¹²⁴ For example, a product imported into a country as a "good" may be subject to the VAT, rather than withholding taxes or income taxes, as long as the destination country does not have a permanent establishment in the country.¹²⁵ An "intangible," however, may be subject to withholding taxes on its royalty payments, but not subject to the VAT.¹²⁶ Finally, a "service" may not be subject to any taxes at all, as long as the services are provided by a foreign company and are performed outside the country.¹²⁷

nomic interconnectedness increases. *Id.* at 267-68. See also Nancy H. Kaufmann, *Fairness and the Taxation of International Income*, 29 LAW & POL'Y INT'L BUS. 145, 203 (1998) ("An equitable international tax system will not exist until some international consensus can be reached on how countries should share among themselves the competence to tax. Attaining an international consensus requires a great deal more transnational dialogue than has yet occurred. Political and economic pressures make that process difficult, if not Utopian.").

122. See Edward Morse, *State Taxation of Internet Commerce: Something New Under the Sun?*, 30 CREIGHTON L. REV. 1113, 1130-38 (1997). In United States, only two states (Hawaii and New Mexico) apply the sales tax to services in addition to goods—a situation that Professor Morse says arguably could be classified as "discriminatory." *Id.* The advent of digitized and other products delivered via e-commerce further muddies the issue. *Id.*

123. See *Taxes: OECD Studying Ways to Unify Taxation of Electronic Commerce*, INT'L BUSINESS & FINANCE DAILY (BNA) (Feb. 26, 1998), available in LEXIS, BNA-IBF Database.

124. See James D. Cigler, Harry C. Burritt, and Susan E. Stinnett, *Cyberspace: The Final Frontier for International Tax Concepts?*, 7 J. INT'L TAX'N 340, 341 (1996). See generally Michael J.A. Karlin, *Computer Program Prop. Regs. are a Good But Cautious Start*, 8 J. INT'L TAX'N 64 (1997) (illustrating how sticky classification issues involving evolving new technologies can be). Karlin examines new IRS Proposed Regulations dealing with the classification of different transactions in software, and finds the Proposed Regs lacking. *Id.* Karlin contends that, ultimately, certain classification problems will require a legislative solution, based upon an "international consensus." *Id.* at 73.

125. See Cigler, Burritt, and Stinnett, *supra* note 124, at 341.

126. See *id.*

127. See *id.*

PART TWO: EXPLANATION AND ANALYSIS OF KEY CURRENT PROPOSALS FOR TAXING E-COMMERCE

I. DOES THE "BIT TAX" BYTE?

A. THE "BIT TAX" PROPOSAL

Perhaps the most controversial of the currently proposed e-commerce taxation schemes, the "bit tax" is a tax on the interactive digital traffic on the Information Superhighway.¹²⁸ The tax would apply to all digital "bits" of information that flow through telecommunications traffic lines that carry interactive digital information.¹²⁹ The tax would be applied on the flow volume of bit data,¹³⁰ and then collected by telecom carriers, satellite networks, and cable systems, who would send it directly to governments.¹³¹ In order to eliminate double taxation, the bit tax would only apply to value added portions of interactive digital transactions.¹³² Arthur Cordell, creator of the bit tax proposal, sees interactivity as making the transaction valuable, and, hence, taxable.¹³³

B. POSSIBLE BREACHES OF BASIC TAX PRINCIPLES

The main appeal of the bit tax is its ostensible simplicity—a specified tax rate is applied to the volume of interactive cyberspace "traffic" travelling over lines run by telecommunications carrier companies, and the resulting tax revenues then flow directly to national governments.¹³⁴ However, such simplicity may be more apparent than real, for the bit tax presents vexing problems of how to accurately measure the volume of data flow

128. See Arthur J. Cordell, *New Taxes for a New Economy* (visited October 3, 1998) <<http://www.usask.ca/library/gic/v2n4/cordell/cordell.html>> (originally presented September 14, 1995 at Victoria University in University of Toronto, before the World Leadership Conference); Arthur J. Cordell, *Taxing the Internet: The Proposal for a Bit Tax* (visited March 8, 1999) <<http://www.arraydev.com/commerce/JIBC/9702-05.htm>> (originally presented February 14, 1997 in a speech to the Harvard Law School). Aside from Arthur Cordell, the bit tax proposal's creator, the bit tax has been also been taken up by the EC's Maastricht Economic Research Institute on Innovation and Technology (MERIT). See Laura Bright, *Taxation in International Electronic Commerce, Incentives and Barriers to International E-commerce* <<http://web.syr.edu/~lbrighty/taxtext.htm>> (visited March 2, 1999).

129. See *New Taxes*, *supra* note 128.

130. See *id.*

131. See *id.*

132. See *id.*

133. See *id.*

134. See *id.*

and how to precisely separate which data is taxable and which is not.¹³⁵ Consequently, tax collections could either be inflated or deflated, bringing unintended distortions in the tax base and instabilities in the tax system. Additionally, taxing business transactions in a different manner specifically because they are conducted by means of electronic commerce violates the principle of tax neutrality.

A distinguishing characteristic of the bit tax is that the entire burden of collecting and remitting the tax is borne by the carrier company.¹³⁶ While it is arguable that carrier companies possess the necessary technical and labor resources to effectively perform such a function, it is uncertain who, in the final analysis, would shoulder the bulk of the tax burden or incidence.¹³⁷ Would carriers absorb the cost, or would they pass it onto consumers?¹³⁸ If carriers choose to pass the costs onto consumers (a reasonable assumption, it appears), they would have to do so in a non-neutral manner because carriers lack the means to accurately separate e-commerce from non-e-commerce data flows.

C. PROBLEMS WITH COMPLIANCE AND ENFORCEMENT

With a bit tax, there could also be problems with enforcing compliance on the part of carrier companies. Without a central international regulatory agency to oversee the carriers, there would be difficulties in ensuring that companies collect the correct amount of tax and accurately allocate the funds to the designated governments. Even if such an agency were created by international treaty or agreement, it seems doubtful that sovereign governments would accede to international jurisdiction and oversight over the activities of their key telecommunications corporations.

So, why not have the carrier company's host country enforce bit tax regulations on the carrier? This sounds feasible at first, but deeper inquiry suggests it would not be. Presumably, any practical form of the bit tax would be some sort of consumption-based tax. Since, in many e-commerce transactions, the country of consumption may not necessarily be the carrier company's host country, there would be little economic incentive for the

135. See WTO Report, *supra* note 22.

136. See New Taxes, *supra* note 128. This paper uses the term "carrier company" as an all-encompassing phrase including telecom carriers, satellite network providers, and cable system operators.

137. See *id.*

138. See *id.*

carrier's host country to expend economic and labor-power resources to monitor the carrier's e-commerce tax collection and allocation activities.

II. THE EUROPEAN E-COMMERCE VAT PROPOSAL

A. HOW THE EUROPEANS WANT TO TAX E-COMMERCE

In the European plan, software manufactures would be required to devise a method to keep track of e-commerce sales.¹³⁹ Banks would then process the transactions, withhold taxes from the sales, and pass the proceeds onto the appropriate government.¹⁴⁰ Banks could offer such a service for fee to clients, and national governments would help banks defray part of the collection costs.¹⁴¹ In order to adhere to the principle of tax neutrality, the E.U. has proposed classifying e-commerce "virtual goods" as "services."¹⁴² This distinction is important because E.U. VAT legislation taxes goods and services differently.¹⁴³ Current E.U. VAT tax laws¹⁴⁴ provide that the sales of services within the E.U. would be subject to tax, but the provision of services from within the E.U. for consumption outside the E.U. would not be taxed.¹⁴⁵ Adaptation of current VAT rules, then,

139. See Schenker, *supra* note 101; See also Anne Marie Roussel, *Don't Let VAT Stymie Your Commerce Plans*, INTERNET WEEK 31, November 2, 1998.

140. See *id.* See also John Kennedy, *Taxing the Net: The European Union is Keen to Implement a Framework for Applying VAT on Internet Transactions*, BUSINESS & FINANCE, October 22, 1998. At a recent OECD meeting, considerable opinion existed among governments that e-commerce transactions should fall under the ambit of existing VAT, customs and excise taxes. *Id.* at 2.

141. See Schenker, *supra* note 101.

142. . See Kennedy, *supra* note 140, at 2. See also *Tax-free E-commerce*, ACCOUNTANCY, August 1, 1998.

143. See Kennedy, *supra* note 138, at 2.

144. See generally Tracey A. Kaye, *European Tax Harmonization and the Implications for U.S. Tax Policy*, 19 B.C. INT'L & COMP. L. REV. 109 (1996). The European Community has been intensely at work in the late 1990s attempting to attain a harmonization its members' corporate tax laws, in anticipation of the single, integrated European Market. *Id.* at 110-11. An example of these efforts has been the recent "VAT simplification" Directives, aimed at improving internal market functioning by reducing complexities in the current E.U. taxing system. See *VAT Simplification*, 1 COLUM. J. EUR. L. 555, 555 (1996). The VAT has been the object of primary focus in EC's efforts, because of the VAT's key role in "partly financing the Community itself." Kaye at 110-11. With the formation in 1994 of the European Economic Area (EEA), the EEA became the world's largest free-trade zone, comprising a single market of 370.5 million people. *Id.* at 112-13. The implications of these developments is that the United States must be increasingly global in its outlook, and ever-aware of the economic movements of its global counterparts. *Id.* at 114-15.

145. See Kennedy, *supra* note 140, at 2.

means that the sales of e-commerce products within the E.U. for consumption within the E.U. would be subject to E.U. VAT taxes, but sales from the E.U. of e-commerce products for consumption outside the E.U. would not be subject to the VAT.¹⁴⁶

B. ADVANTAGES OF THE EUROPEAN PLAN

The main hallmark of the European plan—the adaptation of an existing VAT consumption-type tax to e-commerce transactions—preserves the principle of tax neutrality,¹⁴⁷ with minimal disruption expected for most of the world's current tax regimes.¹⁴⁸ Additionally, because banks and service providers collect and disburse tax funds, there are no apparent procedural inconveniences for e-commerce businesses and their customers with the implementation of the tax.¹⁴⁹

C. THE PIVOTAL ROLE OF BANKS IN THE EUROPEAN PLAN

As presently framed in the E.U.'s proposal, banks play the *preeminent* role in the the plan. This raises several troublesome issues. Because banks would collect and disburse e-commerce tax revenues to the appropriate governments, they would perform an essentially governmental administrative function. Banks, however, are not governmental agencies, nor even pseudo-governmental apparati. Since banks would be motivated by the desire to increase the volume of e-commerce transactions processed (to garner greater fees from taxes collected), an inher-

146. See *id.* See also OECD, *Dismantling the Barriers to Global Electronic Commerce*, Background Paper for the Turku Conference (1997). The OECD states that, "electronic commerce raises particularly difficult questions for VAT, as the vast majority of services concerned are normally taxed at a positive rate of VAT when supplied for domestic consumption and at a zero rate for export. The VAT rules governing accountability of international services have therefore always posed problems for tax administrations. Such problems are greatly amplified for e-commerce services. . .[f]or VAT, "place of supply" for electronic commerce may come to be the place where the service is consumed." *Id.* at 19. It appears that the E.U., with its e-commerce proposal, has conceded the OECD's last point.

147. See Schenker, *supra* note 101. See also Kennedy, *supra* note 140, at 2. Elizabeth Olivi, spokesperson for Mario Monte, E.U. Tax Commissioner, stated the importance of not introducing new taxes and adapting existing taxes, particularly the VAT, for taxing e-commerce transactions. The new system must be neutral, asserts Olivi, so that e-commerce taxes will not distort competition. *Id.*

148. The VAT, a form of consumption tax, is the single largest source of tax revenue for all OECD countries, except the U.S. and Australia. See Schenker, *supra* note 101.

149. See *id.*

ent conflict of interest would be created if banks are also vested with the responsibility of allocating tax funds. The danger lies in the potential for fraud and abuse in the handling and disbursement of tax revenues by banks. As was noted previously, e-commerce transactions are projected to grow to \$US 1 trillion dollars with the next few years,¹⁵⁰ and concomitant consumption taxes could equal literally hundreds of billions of dollars per annum.¹⁵¹ With such a high flow of tax revenue, strict auditing and monitoring controls would be essential for maintaining integrity of the system.

Additionally, any international e-commerce VAT system could conceivably involve hundreds of tax rate schedules and protocols with which participating banks must comply. Thus, aside from the potential for bank fraud and abuse, it would also be difficult to know whether banks are accurately and timely allocating tax funds to governments. Confusion could arise if a relatively large number of banks are collecting and allocating funds to many countries. Different banks from different regions or countries could have differing turnaround times in disbursing tax funds, creating timing expectation problems for countries that are acutely reliant on consumption taxes for their tax base. An international regulatory agency could conceivably be created to oversee and organize banks' activities, but resource and jurisdictional problems would be difficult to surmount.¹⁵²

Another major area of concern with the European plan involves the selection of participating bank institutions. The work of collecting, processing, and disbursing tax funds would require the careful selection of banks that possessed the requisite financial, technological, and organizational capabilities. The situation could become precarious if a participating bank became financially troubled or insolvent while holding countries' e-commerce tax funds during the collection process. The issue is especially germane and critical given the current unstable global economic and banking environment.¹⁵³

150. See Scoffield, *supra* note 12, at B6.

151. Since VAT rates in the E.U. range from 16% to 25%, consumption tax revenues could reach \$US 160 to 250 billion dollars per year, assuming projections of \$US 1 trillion in e-commerce sales prove true. See Schenker, *supra* note 101.

152. See Reuters, *EU Seeks to Tax E-commerce*, (visited September 23, 1998) <<http://www.news.cnet.com/news/Item/0-1005-200-33082.html>>.

153. See Lawrence L.C. Lee, *The Basle Accords as Soft Law: Strengthening International Banking Supervision*, 39 VA. J. INT'L L. 1, 1 (1998). With the advent of economic globalization and the trend of deregulation and multinationalization of banks and financial institutions, the risk increases significantly for

D. THE BURDEN ON SOFTWARE MANUFACTURERS AND SERVICE PROVIDERS

Since software manufacturers and service providers have the task of tracking e-commerce sales, they too, have a high burden under the European proposal.¹⁵⁴ Presumably, the software manufacturer/service provider would have to rewrite their software codes to accommodate the new tax requirements,¹⁵⁵ and would then be required to give detailed information on e-commerce transactions to banks. An issue arises regarding who would ultimately absorb the cost of the information gathering—the provider or the consumer? If the consumer absorbs the cost, then he or she would be subject to a “double whammy”—the tax plus the added cost of the provider’s responsibility to track sales. Furthermore, it is arguable whether adequate incentive would exist, absent fear of government sanction, for the provider to give accurate and timely transaction information to banks. Are governments prepared to expend the necessary resources to oversee and enforce provider compliance under the plan? Do governments have incentive to do so? These are all important questions to address and answer before the E.U. plan could be successfully implemented. Finally, the E.U. plan appears to raise serious privacy issues,¹⁵⁶ since information on consumers would pass through two channels—the software manufacturer/service provider and the bank who handles the tax processing.¹⁵⁷

international financial crises. *Id.* at 2. It is feared, for example, that the recent Asian financial crisis could have spillover effects for the world economy. *Id.* See also Daniel M. Laifer, *Putting the Super Back in the Supervision of International Banking*, Post-BCCI, 60 FORDHAM L. REV. S467, S467 (1992) (stating banking regulators will be called on increasingly to respond to the “highly mobile, innovative, and risky financial environment”); John H. Chun, “Post-Modern” Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?, 64 FORDHAM L. REV. 2647, 2650 (1996) (indicating the Mexican banking crisis has been termed by commentators as the first example of what can go wrong in the post-modern, globally interconnected banking and financial system).

154. See Schenker, *supra* note 101; Anne Marie Roussel, *Don’t Let VAT Stymie Your Commerce Plans*, INTERNET WEEK 31, November 2, 1998.

155. See Roussel, *supra* note 154, at 1. Presumably, such a high burden would not be popular with software manufacturers and service providers. *Id.*

156. *See id.*

157. Since one of the E.U.’s primary concerns is data privacy for consumers, it appears that the European VAT proposal contradicts an E.U. priority.

III. THE CLINTON ADMINISTRATION'S E-CARD PROPOSAL

A. HOW THE CLINTON ADMINISTRATION WANTS TO TAX E-COMMERCE

The Clinton Administration has recently proposed a high-tech variant of the traditional VAT taxing scheme.¹⁵⁸ Consumers would purchase digital cash cards¹⁵⁹ (also known as "smart cards," or "e-cards") at banks that would allow the seller to identify the country the purchase was from.¹⁶⁰ The VAT would be calculated, based upon the place of consumption, and immediately collected with the sale.¹⁶¹ The funds would then be placed by the seller with a third party escrow agent, who would funnel the money to the appropriate government.¹⁶² It is estimated that governments could receive their funds weekly, instead of the two to four months it now takes governments to collect the VAT.¹⁶³

B. CLINTON PROPOSAL

The Clinton e-card proposal presents several distinct advantages. First, as with the European plan, the e-card plan is tax-neutral. As opposed to the bit tax, e-commerce transactions under the Clinton plan would not be taxed differently than other business transactions. And, since the e-card proposal is a VAT

158. See Strassel, *supra* note 78.

159. See Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, §8.4 (1996) (if the cash cards operate as intended, they are "likely to represent an important means by which taxpayers and tax administrators can prove the identity of electronic counter parties"). See also John K. Sweet, *Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles*, 146 U. PA. L. REV. 1949, 2006 (1998) (a "smart card" would be used by an e-commerce consumer, which would have information about the consumer's residence); Kerry Lynn Macintosh, *How to Encourage Global Electronic Commerce: The Case for Private Currencies on the Internet*, 11 HARV. J.L. & TECH. 733, 734-35 (1998) (commenting on President Clinton's e-card proposal and on "smart cards" embedded with a microchip that can be used for making e-commerce purchases). See generally Thomas W. Beetham, *The Community Reinvestment Act and Internet Banks: Redefining the Community*, 39 B.C. L. REV. 911, 911 (1998) (commenting on the rapid development of new technologies that are affecting the way financial institutions and banks do business—for instance, cards that enable Internet users to type an access code and download money into the computer).

160. See Strassel, *supra* note 78.

161. See *id.*

162. See *id.*

163. See *id.*

consumption tax, the E.U. countries could maintain tax consistency, and the United States and Australia could tax e-commerce transactions as they currently tax sales transactions.¹⁶⁴

Another advantage of the Clinton Administration's plan involves the creation of an escrow agency.¹⁶⁵ By centralizing the "funneling" of tax revenues to appropriate governments through an escrow agent,¹⁶⁶ the plan provides for greater consistency and predictability than the European plan, which calls for an indeterminate number of private banks to perform the same task.¹⁶⁷ Also, governments can deal with one centralized body in case any disputes, concerns, or queries arise over the processing of tax transactions. Governments can readily learn one agency's dispute and query protocols, instead of dealing with a disparate number of banks.

A third advantage of the e-card plan is that it does not call for a source-based approach to taxing e-commerce tax revenues.¹⁶⁸ This should ease the concerns of developing countries, since the e-card plan is a residence-based plan and rewards developing countries when its residents conduct business with residents of other countries.¹⁶⁹

Finally, the e-card helps preserve the privacy of consumers,¹⁷⁰ a thorny issue with the E.U. countries, and a weakness of the aforementioned European VAT proposal. The e-card's only

164. See *id.*

165. See Strassel, *supra* note 78.

166. See *id.*

167. See Schenker, *supra* note 101. Recall also that the Clinton Administration estimates that countries could receive their tax revenues weekly, instead of the two to four months it takes governments to collect the VAT. Strassel, *supra* note 78. This speed would afford countries enhanced cash flow access and allow for improved financial projection analysis. See also John K. Sweet, *Formulating International Tax Laws in the Age of Electronic Commerce: The Possible Ascendancy of Residence-based Taxation in an Era of Eroding Traditional Income Tax Principles*, 146 U. PA. L. REV. 1949, 2007 (1998) (indicating the efficient allocation of tax revenues of the Clinton e-card proposal should be well-received by both developed and developing nations).

168. See Sweet, *supra* note 167, at 2007.

169. See *id.*

170. See generally Mark E. Budnitz, *Privacy Protection for Consumer Transactions in Electronic Commerce: Why Self Regulation is Inadequate*, 49 S.C. L. REV. 847 (1998). American consumers share Europeans' wariness of conducting transactions on the Internet. A 1997 Harris survey found that a "majority" of consumers are worried about the confidentiality and security of engaging in online activities and Internet transactions and "do not trust online and Internet service companies." *Id.* at 849-50. Consequently, argues Professor Budnitz, e-commerce will be successful only to the extent of consumer confidence, and government regulation is an "important step" in promoting electronic commerce. *Id.* at 884-85. Furthermore, argues Budnitz, industry self-regulation is an "in-

"identifier" is the country of origin of the purchase.¹⁷¹ Otherwise, it appears the e-card is much more like cash, and much less conspicuous than a check or credit card.

C. THE SELLER'S SIGNIFICANT ROLE

Because the seller is responsible for collecting the tax funds, the seller assumes a prominent role in the Clinton e-card plan.¹⁷² The seller's task under the Clinton plan is analogous to that of U.S. employers' roles in calculating, collecting, and remitting employee payroll taxes to the Internal Revenue Service.¹⁷³ Thus, the same sorts of compliance and enforcement issues arise under the e-card plan as do under the collection of U.S. payroll taxes. For example, the potential exists for the e-commerce seller to simply keep the tax proceeds and not forward them to the escrow agent.¹⁷⁴ Who will enforce compliance on

adequate substitute" for legislation with respect to matters of e-commerce privacy and security. *Id.*

171. See Schenker, *supra* note 78.

172. *See id.*

173. *See, e.g.*, Keith Benes, David Gallai, Louisa J. McGruder, Anne M. Petersen, *Tax Violations*, 35 AM. CRIM. L. REV. 1219, 1241-42 (1998). Under federal income tax provisions, employers are required to submit the following payroll taxes: FICA payments, FUTA payments, and required withholding in connection with employee income taxes. *Id.* (*quoting JOHN J. TIGUE, JR. & LINDA A. LACEWELL, THE WAGES OF SIN: THE IRS LOOKS AT OFF-THE-BOOKS PAY*, at 3 (1996)). The Internal Revenue Code provides that "whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax collected or withheld shall be held to be a special trust fund in trust for the United States." I.R.C. §7501. *See also* Benes at 1241-42. Thus, the employer is deemed a "trustee" of the collected or withheld tax funds. *Id.* Analogously, the seller, under the Clinton e-card plan, could also be deemed a "trustee," and would bear substantial burdens for compliance. Under the Internal Revenue Code, employees face substantial civil and criminal penalties for non-compliance. *See, e.g.*, I.R.C. §§7201, 7202, 7203, 7206, and 7212(a); Benes at 1220. Similar legislation would have to be passed by Congress regulating the seller's role under the Clinton plan. It is plain that such an undertaking would require significant intra-governmental cooperation, but also planned coordination between national governments.

174. *See* Benes, *supra* note 173, at 1241-42. An analogous situation exists with current employer payroll taxes. Because employers only need remit withheld payroll taxes on a quarterly basis (*see* Treas. Reg. §§31.6011(a)-1, 31.6011(a)-4, *quoted in* Benes, footnote 160), unethical employers face a "strong temptation" to use payroll tax funds for their own business or personal purposes. *Id.* However, the situation may be less critical under the Clinton plan, because the plan calls for weekly disbursement by sellers of collected tax funds from consumers. Nonetheless, unethical e-commerce sellers would still face the temptation of keeping tax funds earmarked for allocation to national governments. *See also* this note's proposal for a recommendation on this issue. *See generally* Kirsten Harrington, *Employment Taxes: What Can the Small Busi-*

sellers? The seller's host country will probably not want to expend resources for enforcement and monitoring. A corollary of this concern is the issue of securing compliance from sellers in developing countries. There could be difficulties in obtaining co-operation from the host country in the case of non-compliant sellers.

Similarly, an issue arises as to who will bear the burden of the extra costs of seller compliance under the plan. As with the European plan, consumers could face a "double whammy" of increased costs for e-commerce products in addition to the consumption tax. This could be a significant damper on the growth of e-commerce.

D. THE ESCROW AGENT'S ROLE

Since the escrow agent may be funneling billions of dollars to governments annually, it plays a critical role in the Clinton Administration's plan. The credibility and stability of the agent is a key factor in establishing government confidence in the e-card system, allowing governments to feel secure in entrusting the escrowing of their valuable tax revenues to a outside party. There are two crucial unanswered questions in this regard: (1) who will be selected to be the escrow agent, and in which country will the agent be located, and (2) how will the agent's activities be monitored to ensure the accuracy and integrity of its performance? Some ideas for further discussion, with respect to handling these issues, are included in this note's proposal, *infra*.

E. CONCERN OVER E-CARD TECHNOLOGY AND CONVENIENCE

Since, under the Clinton proposal, consumers would be required to purchase the e-cards at banks, a legitimate concern is raised about whether this inconvenience would be enough to stymie consumers' appetites for e-commerce transactions. Would the e-card requirement retard e-commerce growth? This author hypothesizes that such a requirement would not, in the long run, retard the development of e-commerce. Once a "critical mass" evolves on the Internet, where significant products, goods, and services are conveniently available on-line, it is not difficult to envision consumers purchasing e-cards as a matter of routine. The key requirement would be that sufficient goods and

nessman Do?, 10 AKRON TAX J. 61 (1993) (citing the burdens that the small businessperson faces with respect to the collecting, withholding, and filing of payroll taxes, and the Internal Revenue Service's escalated efforts to enforce such filings).

services be available on-line, and with sufficient convenience that consumers would view the use of e-commerce as providing net benefits compared to traditional means of purchasing goods and services, such as driving to a store or ordering products by mail-order.¹⁷⁵

Another area of concern could be the integrity and security of the e-cards themselves, and whether the cards would be subject to possible fraud and abuse.¹⁷⁶

PART THREE: A PROPOSED REGIME FOR TAXING E-COMMERCE

This note recommends that the Clinton Administration's VAT e-card proposal be adopted, with some modifications and edifications.

The first recommendation is that an international e-commerce "taxation agency" should be created in order to: (1) oversee the proposed e-card taxation regime and, perhaps, report to an international economic organization, such as the WTO, OECD, or UNCITRAL. It is important that the agency be under the aegis of a respected international body, to lend credibility and influence to the new agency; (2) manage and implement new e-card and other e-commerce technologies that could improve the system; (3) coordinate and manage the separate consumption taxing schedules of the various countries, to ensure that each country receives its proper and correct share of e-commerce

175. It may be instructive to compare the e-card to similar inventions, such as bank ATM cards, credit cards, and long distance calling cards. Consumers appear to view the use of such inventions as time-saving, convenience devices. If the quality of products and services, and the convenience of e-commerce is high, then consumers may view the purchase and use of e-cards as a relatively trivial expense of effort. Thus, this author believes that the requirement of e-cards would not, in itself, and in the long-run, be a determinative factor in consumers deciding not to use e-commerce. In the short run, however, it may very well be that the e-card requirement will be a hindrance to consumer acceptance of e-commerce.

176. See also Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce* (1996), §8.4 (discussing some of the issues involving e-card security); Kerry Lynn Macintosh, *How to Encourage Global Electronic Commerce: The Case for Private Currencies*, 11 HARV. J.L. & TECH. 733, 737-38 (1998). Developers of the new smart cards are adapting existing technologies, such as magnetic stripe cards and credit cards to e-commerce. *Id.* Thus, perhaps current solutions to the problems of fraud and security with existing technologies could also be applied to the new e-card. In any event, it appears reasonable to assume that the potential for fraud and security breaches with the e-card would not be any greater than currently exists with credit cards and the like.

tax revenues from the escrow agent; (4) monitor and audit the activities of the escrow agent—especially in regards to the accurate and timely allocation of tax funds to their appropriate countries. The agency will help to decrease the likelihood of abuse and fraud on the part of the escrow agent; and (5) oversee and manage the wholesale distribution of e-cards.

Because the financial strength and solvency of the escrow agent is of utmost importance, the United States and E.U. should take a leading role in the selection of the agent.¹⁷⁷ Perhaps an international bank, similar to the IMF, could be created solely for the responsibilities of escrowing and distributing the funds. In this case, the tasks and responsibilities of the escrow agent merges with that of the agency proposed above.

This note's second recommendation is that agreements between national governments should include provisions that each government commit to passing regulations designed to enforce and monitor compliance of sellers that are residents of the country. Such regulations should outline the requirements of sellers in collecting and withholding tax funds from the e-commerce transactions in which it participates, and also detail the domestic agency that would be responsible for domestic compliance issues.¹⁷⁸ Additionally, this note suggests that a fund should be set up, with contributions from the wealthiest countries, to help all Internet retailers defray the costs of compliance. Also, the GATT countries should agree to commit adequate money and resources to enforce Internet retailer compliance with respect to submitting proper tax proceeds to the escrow agent.

Finally, with respect to the e-cards, this note recommends that further research should be done to find ways to more widely distribute the e-cards, in addition to having them available for purchase from banks. Perhaps, the e-cards could also be sold online over the Internet, from established retail outlets, such as computer and office supply stores. This will lessen inconvenience for consumers and cause less of a drag on e-commerce growth in

177. This is because of the relative strength and stability of financial institutions in the United States and European Union. See, e.g., Daniel Laifer, *Putting the Super Back in the Supervision of International Banking, Post-BCCI*, 60 FORDHAM L. REV. S467, S499-S500 (1992) (illustrating the emphasis that the United States and EC countries place on regulation of banks and financial institutions).

178. It would appear prudent, for instance, for the Treasury Department to assume such responsibilities in the United States, since the Treasury Department is already charged, via the Internal Revenue Service, with the enforcement of federal tax laws.

the short run. Also, software should be researched, developed, and provided to sellers that would enable sellers to quickly calculate taxes owed, according to the tax rate schedule of the country of the consumer. Finally, software should be researched and developed that is embedded with anti-fraud and anti-tampering capabilities to reduce incidents of seller fraud and non-compliance.

Since the developed nations are the wealthiest countries, and currently have the biggest stake in seeing e-commerce develop, it appears equitable for these countries to shoulder the greatest burdens in financing and coordinating the recommendations as set out above. However, since the ultimate success of global e-commerce will most likely rely in part on the goodwill and resources of developing countries, it is suggested that most planning, negotiations, and implementation of this Note's proposals be coordinated under the watchful eye of a respected international organization (such as the OECD or WTO), where the voices and concerns of the developing nations could be given a forum for expression.

PART FOUR: CONCLUSION

Electronic commerce has grown tremendously in a short time, and is forecast to grow even more in the near future. A coordinated and consistent global tax policy is a rational response to the issue of how to manage valuable tax revenues from this new transactional medium. This Note recommends that the Clinton Administration's e-card plan be adopted, with a few modifications. While not a perfect plan, this proposal improves upon the strongest of the three major plans currently being scrutinized by the international tax community. The creation of an international monitoring bureau and centralized escrow agency, as well as the wider distribution of e-cards to consumers, will maintain a feasible balance between tax compliance objectives and a practicable level of transactional freedom that should leave e-commerce growth levels unfettered.