AIC Key Recommendations

- ✓ Multilateral Approach to implement GST for digital and low value goods
- ✓ Simplified data driven compliance model for overseas vendors
- ✓ Align to OECD and EU implementation timelines to allow for market adjustments
- ✓ Collaborate with Industry
- ✓ Enable Cross border data flows so SMEs can access global markets

Indirect Taxation Challenges in the Digital Economy

Digital Trade

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Digital trade will continue to grow as a portion of the overall global economy. According to one study, it is expected that digital trade will make up 50% of the value of the global economy by 2025.[1] As digital trade continues to grow, governments around the world will have to draft new tax laws and will look for new procedures of monitoring tax compliance.

Historically, the place of taxation of Value-Added Taxes (VAT), Goods and Services Tax (GST) and similar types of consumption taxes (collectively referred to as "VAT") have traditionally been based on the location of the supplier of the goods and/or services, as it was generally expected that the customer would be located in the same country as the supplier's location.

Today many governments are examining the collection of VAT on cross border trade of both digital and low value tangible goods. Whether it be to level the playing field between domestic and international sellers or an effort to raise overall tax revenues, it is important that a measured approach is taken so as not to disrupt the trade of digital products which are increasingly growing in the share of the overall global economy.

Given the advent of the digital economy, customers are able to shop online for digital goods, services and intangibles without the need for suppliers to be physically located in the customer's country of residence. Accordingly, in these situations where the supplier is in a country different from the end customer, there may not be any VAT collected in the country where the digital goods, services and intangibles are being consumed. This can cause a reduction government tax revenues as more consumer purchases are done online.

To address this issue, some government authorities have implemented or are intending to implement the recommendations in OECD/G20 Base Erosion and Profit Shifting (BEPS) Action 1 2015[2] Report on *Addressing the Tax Challenges of the Digital Economy*, which in turn recommends applying the principles of the *OECD International VAT/ GST Guidelines*. The OECD's recommendation is to allocate the VAT taxing rights to the country in which the customer has its usual residence, such that VAT will be imposed in the country of consumption (the *Destination Principle*).

To encourage compliance by non-resident sellers and to facilitate VAT collection, the OECD is recommending a simplified VAT registration and compliance regime for the non-resident seller of digital products made to end consumers (ie "B2C suppliers"). According to the OECD, a balanced approach should be taken during implementation to ensure that the

[1] http://www2.itif.org/2013-usitc-digital-trade-global-economies.pdf

[2] http://www.oecd.org/ctp/beps-2015-final-reports.htm

pursuit for tax revenues does not overburden small businesses. "Particularly when it comes to VAT/GST with business acting as tax collector, it is key to strike the right balance between safeguarding VAT/GST revenues for governments and keeping the administration costs and compliance burden for business low and manageable" [3]

For digital products sold by non-residents to businesses (ie "B2B suppliers"), the OECD is recommending that the business customer accounts for the VAT compliance through the "reverse charge mechanism" wherein the business customer will declare the VAT on behalf of the non-resident seller and at the same time claim a credit for the VAT. The non-resident seller would therefore not be required to register and account for VAT in the customer's jurisdiction for B2B supplies. For both B2C and B2B cases, the procedures must be simple and implemented easily, otherwise global digital trade will be negatively impacted or tax compliance will be low.

Global Challenge

Many countries across the world require foreign sellers to calculate VAT or GST at the rate of the country of residency of the consumer and pay to the appropriate related tax authority. The challenge for many sellers is how to comply with these new requirements and how to understand numerous global taxation regimes. For small businesses who do not have large teams of employees this task could be daunting.

Traditional business models are changing and tax authorities are seeking innovative ways to capture tax revenues from these new business models. As digital trade continues to grow, it is vital that governments capture taxes without stunting the growth of digital trade.

In December of 2016, the European Commission introduced a system that creates an EU wide VAT portal, that provides EU countries with a simplified tool for VAT compliance that enables the collection of VAT in the Member State of the final consumer. This system aims to have a fairer distribution of tax revenues across the EU countries. The new system aims to reduce the compliance costs for businesses and protects Micro, Small and Medium Enterprise (MSMEs) with a minimum sales threshold. This new system is scheduled to be implemented over the period of 2018-2021.

Asia

Many countries in Asia have already taken steps to collect VAT on cross border digital trade. Korea, Japan and New Zealand have already taken measures which will require VAT collection for cross border e-commerce by requiring overseas vendors of digital products to register with local tax authorities. In July 2017, Australia plans to implement a program which will see foreign sellers of all digital ***and*** low value tangible goods having to collect the GST as the *de minimus* exemption threshold is reduced to zero from the current level of AU$1000. This initiative aims to level the playing field for domestic retailers and those who sell goods (both digital and tangible) into Australia from foreign markets. There are however several complexities which may prevent this new bill from being implemented as planned in 2017.

In other markets, such as Singapore, Taiwan, Thailand and Indonesia, there are ongoing

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[3] http://biac.org/wp-content/uploads/2017/04/2017-04-14_Business_OECD_governments_cooperate-to-ensure-efficient-VAT-regimes.pdf

consultations and research into implementing similar changes which would see VAT / GST collections on incoming digital and tangible goods from foreign markets. Tax authorities should engage with industry players to ensure that any changes to taxation schemes does not distort digital trade and are in fact implementable.

Challenges

Tax Compliance

There are a variety of international e-commerce platforms that are not technically ready to collect VAT or GST taxes for other countries into which they sell goods. Third party marketplace platforms such as Alibaba, Etsy and eBay for example do not own or sell goods, but merely connect millions of buyers and sellers of goods. Who will tax authorities ask to collect taxes for goods sold on third party marketplaces? For MSMEs who sell into foreign markets, the cost for tax compliance may be significantly high, either restricting access to such markets or adding significant cost burdens for compliance. In the EU for example, it was noted the average annual costs for VAT compliance cost was on average €8,000 per market, a figure that would be significant for many small businesses.[4]

In the case of Australia, if the government decides to impose GST on such cross-border transactions, they will need to consider the cost implications both to operationalize and enforce the rules from the government's standpoint. It may not make sense if it costs more to enforce the rules outweighing the revenue that is derived. In addition, the government should consider the compliance and operational costs to the affected service providers or e-commerce suppliers located outside Australia. It will require a delicate balance to get it right but it is something which cannot be ignored as the digital economy continues to grow.

Returns

When customers return goods, the e-commerce seller must refund the full amount to the customer, including the VAT. In cases where the seller has to experience long delays in the return of any taxes remitted, this delay could create significant financial burden on MSMEs. VAT recovery systems should be simple, fast and cost effective.

Conclusion

As the digital economy continues to grow and becomes more dominant in the overall economy, governments around the world will seek to tax the sale of cross-border digital goods and services and low value tangible goods in a manner similar to goods and services procured locally. When implementing new taxation laws, governments should engage with industry to make sure these new laws are simple and do not distort the growth of digital and low value tangible goods e-commerce trade. Taxation laws should also be MSME friendly, and support the growth of e-commerce globally to ensure that MSMEs continue to thrive in the global economy.

AIC KEY RECOMMENDATIONS

- ✓ Asia should use a multilateral approach to taxing digital and low value tangible goods - AIC recommends a multilateral approach and alignment by all countries with the OECD consultation timelines of 2021. Given the complexities of e-

[4] https://ec.europa.eu/taxation_customs/sites/taxation/files/swd_2016_382_en.pdf

commerce cross border trade it would be a bold move for individual countries to move unilaterally on this very complex issue

- ✓ Reduce VAT compliance costs which can be significant for MSMEs – if the cost is too high it will stunt the growth of digital trade or increase tax avoidance schemes
- ✓ Have a reasonable minimum sales exemption threshold that will not burden MSMEs
- ✓ Ensure VAT recovery systems are fast, cost effective and data driven
- ✓ Policy makers should involve industry in policy development to avoid unnecessary burdens and market distortions
- ✓ Permit the free flow of data across borders to enable digital trade to flourish and enable local SMEs to benefit from the global marketplace

About the AIC:

The Asia Internet Coalition (AIC) seeks to promote the understanding of Internet policy issues in the Asia Pacific region.

For more information, visit www.aicasia.org