UNICE
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UNICE DISCUSSION PAPER ON

ELECTRONIC COMMERCE AND VAT

Introduction

It is widely agreed that E-commerce poses a major challenge a well as an opportunity to both government and business. Government's task will be to adapt existing regulation including tax laws to this new way of doing business, while the private sector will strive to make maximum use of the opportunities E-commerce offers in terms of both wealth creation and employment. Already 100,000 jobs have been created between 1995 and 1997 and this is only the beginning. Last year the European Commission took the challenge and indicated that it wished to involve business in the process. UNICE affirms that it is prepared to participate fully.

From the guidelines issued by the Commission last year it follows that no new legislation is needed but that existing rules will be adapted to suit E-commerce. Recently, the Commission proposed three options for the (VAT) taxation of E-commerce. Although useful, it is UNICE's opinion that each of the Commission's options only addresses part of the problem. In fact the problem is threefold:
-how to facilitate intra-community E-commerce as much as possible;
-how to tax private consumption;
-how to deal with non-established operators.
Therefore, drawing on both the Commission's options and the telecom experiment, UNICE has developed a more comprehensive proposal for the (VAT) taxation of E-commerce.

Reverse Charge mechanism

This method of taxation has more than one advantage. First and foremost, consideration of the nature of the service (the supply of an entertainment service versus the supply of information for instance) is unnecessary. Bearing in mind that new techniques have created new kinds of products that are susceptible to being taxed in different ways by fifteen different Member States, double or non-taxation will be avoided. Furthermore, the reverse charge mechanism minimises the costs of compliance. Lastly, as the preamble to the Gold Directive points out, the use of the reverse charge mechanism can help prevent tax fraud.

Taxation at the place of supply

For transactions with taxable persons it is proposed that all E-commerce transactions within the EU are taxed at the place of supply. The advantage would be twofold. First, taxation at the place of supply prevents the supplier from having to register in each Member State, thus facilitating compliance. Second, supervision is easier as all E-commerce transactions by a particular supplier must be accounted for in the same Member State. The only disadvantage is that taxation at the place of supply could create a distortion in favour of countries applying a lower VAT rate. This point needs to be addressed to make taxation at the place of supply acceptable to all Member States. A solution could be to set one rate for all E-commerce and/or to reallocate the proceeds.

Single Point of Registration

Regarding third country operators the main question is how these can be taxed. Here, simplicity and enforceability go hand in hand. Therefore, UNICE proposes to use an obligatory registration at a Single Point of Registration (SPR) in the EU for these suppliers. Once registered the same rules as for EU suppliers apply: reverse charging and taxation at the place of registration. The use of a SPR makes registration both less burdensome and more easily controllable. It is clear however that SPR can create the same distortion as mentioned above. This disadvantage is nevertheless small compared to the problems created by not adopting this system. More extensive requirements such as the obligation to register in every Member State will not facilitate supervision nor foster compliance as the costs of compliance will be prohibitive. A possible solution to the distortive effects of SPR could be that the Commission sets up a VAT service centre where third country operators can register for the EU, possibly in connection with a flat rate for the EU.

Control and Audit issues

There are a number of control and audit issues related to E-commerce. However, the opening remark on this issue must be that the administrative treatment of E-commerce should not put any additional or unnecessary burden on European business, as this will seriously hamper the development of E-commerce in the EU. Control issues centre around taxation of transactions involving third country suppliers and transactions with private individuals. Both the locations of the supplier and the recipient must be known to account for VAT. The use of banking details as well as the use of Electronic Signatures (ES) disclosing residence could be considered, although ES can only be used after agreement in the OECD.

Regarding audit issues UNICE would like to extend the use of Electronic Data Interchange (EDI). In 1997, the Member States took the view that article 22 of the 6th Directive does not prohibit electronic invoicing if certain conditions are met. In consequence, the Member States were allowed to experiment with systems of Electronic Data Interchange (EDI). So far, the results have been promising. The use of EDI reduces paperwork and compliance costs both for the taxpayer and the authorities. Moreover, the use of EDI is a perfectly controllable system of electronic invoicing.

Further harmonisation ?

One of the most challenging problems of E-commerce is the extent to which it will trigger a need for harmonisation. Will harmonisation become inevitable as the VAT boundaries between the Member States become harder to uphold every year? In a virtual marketplace residence is as transient as the transferred bits are, which is one of the main reasons why E-commerce is so difficult to tax. Especially in a Single Market differences in VAT treatment and rates can create major distortions as the supply side of E-commerce is not bound to a physical presence in a Member State. Therefore suppliers will be able to make use of differences in VAT systems.

Several harmonisation issues have to be addressed. The different definitions of E-commerce services applied in the Member States can result in double or no taxation. Differences between the Member States' VAT rates will inevitably lead to distortion. Harmonisation of compliance methods (EDI) might be necessary to create a level playing field for European business; a playing field in which compliance is as easy as possible without hampering supervision.

All these issues create a strong argument in favour of more coordination in the field of E-commerce. First and foremost, the coordination will result in the simplicity needed to further the growth of E-commerce and the Internet economy in Europe. Secondly, simplicity is necessary to enforce compliance both by domestic suppliers and by third country operators. Furthermore, as fixed places of establishment are of no importance in the information society, suppliers will have infinite choice of residence.

To conclude this summary of UNICE's more extensive paper on VAT and E-commerce, UNICE would like to express its willingness to sustain a mutually beneficial discussion with the Commission in exploring the field of E-commerce.

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1. GENERAL BACKGROUND TO THIS PAPER

The growth of Electronic Commerce (E-commerce) has proven to be unstoppable and is proceeding at a speed which is faster than that at which the regulatory framework is developing. It has become clear, however, that E-commerce poses a serious challenge to existing (tax) regulations. Last year a conference was held on E-commerce in Ottawa at which it was decided to study the implications of E-commerce for existing regulation. Also it was decided to divide the work between the OECD (direct taxation) and the EU (indirect taxation), although the OECD working parties do include consumption taxes and compliance issues.

Following this conference the European Commission expressed its wish to involve business in producing a distinctive European voice on the Indirect tax aspects of E-commerce. The Commission has set up a small contact group of business representatives. However, organisations such as UNICE were not included in this group. In addition to setting up a contact group the Commission articulated some preliminary views and questions concerning the adaptation of the 6th VAT Directive to E-commerce. Following the helpful initial discussion with DG XXI UNICE wishes to take forward the dialogue with the Commission as quickly as possible.

One remark must be made before going into details. Whatever direction the debate takes one must realise that the EU already lags behind compared to competing countries such as the US while E-commerce is a major driver for economic growth and employment.[1] The Commission estimates that more than 400.000 new jobs related to the information society were created between 1995 and 1997 and that 100.000 of those jobs derived from E-commerce. Therefore, legislation must not create any impediment for E-commerce to reach its full potential for European business and industry.

This paper is set up as follows. Firstly, direct taxation will be addressed briefly in paragraph 2. In the following paragraph the Commission's questions and options will be discussed. Subsequently, UNICE's preference will be advanced and explained in paragraph 4. The next paragraph will cover the impacts of E-commerce on harmonisation and the

[1] According to a recent study by the bureau for International Data Research, the EU currently occupies a 2nd place behind the US, but will move down to a 3rd place behind Asia within three years.

consequences thereof. Finally, in paragraph 6 a short outline will be given of current practices concerning E-commerce.

2. DIRECT TAXATION

UNICE supports the conclusions of the Ottawa Conference and underwrites the key principles summed up at the convention: neutrality, efficiency, certainty, simplicity, effectiveness and fairness and, flexibility. UNICE also agrees that existing taxation rules can embrace these key principles. However this does not preclude changes to the existing measures as long as these changes do not discriminate against E-commerce transactions.
This paper focuses primarily on indirect tax issues because it is seeking to respond to the initiative of the European Commission which is restricted to those issues. On direct taxation UNICE awaits with interest and expectation the studies of the OECD working groups which are currently being formed.

3. INDIRECT TAXATION

Although relatively small for the moment, the predicted growth of E-commerce, both worldwide and within the EU, will pose a serious challenge to the VAT system. Well aware of this fact the Commission has taken up the challenge. In line with the conclusions that were reached in Ottawa last year, the Commission issued six guidelines based on the principles of legal certainty, simplicity and neutrality.

These guidelines are:

1. no new taxes;
2. electronic transmissions will be considered to be services for VAT purposes;
3. ensuring neutrality;
4. making compliance easy;
5. ensuring control and enforcement;
6. facilitating tax administration.

UNICE supports the Commission's guidelines and all of the Ottawa conclusions, but for one. As will be explained in paragraph 4.2, taxation at the place of consumption (Implementation Option 17 of the Ottawa report) is not possible without incurring both high compliance costs for EU suppliers and unenforceable compliance obligations for non EU suppliers.

It follows that existing taxes should be amended to meet the challenges of E-commerce, but only to the extent necessary to counter avoidance or loss of revenue from E-commerce. Moreover, the recovery of the possible loss of revenue due to the supply by third country operators must not be visited upon European suppliers in the form of heavy regulation. The Commission has advanced three options or ways forward. This paragraph will cover these options before addressing UNICE's preference in more detail in paragraph 4.

3.1 Goals

The first question is to ask what the goal of the changes to the VAT system should be. Is it viable to try to catch all consumption with legislation and compliance or should the Directive aim at catching most and try to facilitate E-commerce as much as possible within the EU? The latter, obviously, will cause some VAT to remain unaccounted for. On the other hand it should be said that at the moment almost all VAT related to supplies from non-EU operators to non-taxable persons via Internet remains unaccounted for. Moreover it is clear that the EU already lags behind competing countries like for example the US. In UNICE's opinion legislation should aim at taxing every transaction, but not at all cost. Any attempt to change the current VAT system should be undertaken with great care as not to put the EU at a competitive disadvantage.

The main problem is the taxation of suppliers outside the EU, especially when they engage in transactions with individuals. Although the predictions of private consumption and business to business sales vary widely, all agree that the growth of E-commerce is impressive and will continue to be so. According to one estimate the size of the market was 6,78 bln. Euro in 1998, of which 90% was business to business and will grow to 55,195 bln. Euro in 2001 of which 50% will be business to business. How much is supplied by enterprises outside the EU has not been investigated yet, but the sheer size of this market alone makes it necessary to address the issue of third country suppliers. That means that every solution must take into account the possibility that VAT will not be accounted for, but provide a basic system which requires VAT to be accounted for when supplied to EU residents – business and non-business.

As the Commission has indicated, a lot of questions need to be answered when adapting the current VAT system to E-commerce, most of them related to private consumption and third country operators. Where are supplier and consumer located? Who is to account for VAT and how? Where are the services supplied or enjoyed? The starting point of every answer however, must be that no impediments to the growth of E-commerce are created. In addition, taxation of non-EU suppliers must be ensured or EU businesses will suffer a competitive disadvantage and eventually move out of the EU. This requires a difficult balancing act between catching all revenues and making the tax treatment of E-commerce as easy as possible.

3.2 The Commission's options

So far, the Commission has offered three ways to perform this balancing act. The first option consists of introducing an import/export scheme for non-established suppliers wherein the importer declares the import VAT, while maintaining the current rules for intra-community trade. It would, however, create a competitive disadvantage for European businesses vis-à-vis non-established operators, as there is little possibility to exercise control over a private individual or a non-compliant third country operator. The second option would be to extend the reverse charge mechanism (see 4.1 below).

This option seems to be a good start but does not address the problems of third country operators and private consumption. The third option, proposed by the Commission, would consist of always obliging a third country operator to account for VAT in the EU, but this option does not cover intra-community trade.

The problem is threefold:
-how to facilitate intra-community E-commerce to the greatest possible extent;
-how to tax private consumption;
-how to deal with non-established operators.
Any amendment to the 6th Directive must cover all aspects at once to create a level playing field wherein no impediments to the growth of E-commerce are brought into being and all E-commerce is taxed. In the next paragraph a possible outline for such an amendment is given.

4. UNICE'S OPTION

UNICE believes that E-commerce must be divided into different types of transactions: business to business versus business to private and intra-community versus third country suppliers. The VAT treatment of the different types of transactions must be addressed and the different kinds of services need to be defined. In devising a set of rules it is also important that E-commerce is not considered in isolation. E-commerce consists of a transmission system (telecommunications) and information which is sent over that system. The VAT treatment of the two must be similar because the two are increasingly billed as one charge.

In the table below the different types of transactions are matched to different kinds of VAT treatment according to the demands the transactions make on the VAT system.

The different types of transactions:

	Intra EU	Third country supplier
Business to business	1. Reverse charge, 9(2)e and 21(1b)	3. Single point of registration and Reverse charge, 9(2)e and 21(1)b
Business to private individual	2. Taxation at the place of the supplier	4. Single point of registration and taxation at the place of registration

In the following paragraphs, 4.1 to 4.3, the different boxes are explained. Paragraph 4.4 will address control and audit issues connected to the proposition described in the previous paragraphs.

4.1 Implications of reverse charge mechanism

Currently, article 21(1)b creates the possibility of reverse charging for the services described in article 9(2)e of the 6th Directive. Article 9(2)e is a derogation from the general rule contained in article 9(1) that services are deemed to be supplied where the supplier has established his business. Instead, the services mentioned in article 9(2)e are deemed to be supplied where the recipient has established his business, but only if the recipient is a taxable person in a different member state to the supplier or is established outside the Union. Article 21(1)b states that if article 9(2)e is applicable and the place of supply is transferred to where the recipient has established his business the recipient will account for the VAT on the transaction if he is established within the Community.

The use of reverse charging implies that the supplier must be able to identify the recipient as a taxable person. If the supplier fails to do so the reverse charge is not possible. For transactions within the EU it goes without saying that the VAT registration numbers serve as a workable means of identification. Consequently, VAT will be charged in the Member State of the supplier if the recipient can not identify himself as a taxable person. Therefore it is in his own interest to do so. Supplies to non-EU recipients will obviously not be taxed in the EU.

Switching to a system of reverse charging for E-commerce implies the following changes to the current VAT system. First, all E-commerce transactions must be listed in article 9(2)e. Secondly, the Member States must align the widely varying definitions of services related to E-commerce. Finally, the VAT treatment of third country operators must be devised. The issue of definitions will be addressed in paragraph 5 whereas the third country operators will be the subject of paragraph 4.3.

As reverse charging has greatly reduced the administrative cost of VAT compliance UNICE would like the reverse charge mechanism to apply to all E-commerce transactions between taxable persons within the EU. UNICE is well aware of the Member States' reservations regarding reverse charging, but feels that E-commerce is not so fundamentally different from telecommunications that the arguments in favour of reverse charging in telecommunications do not hold for E-commerce. Furthermore, the Commission's main argument that the possibilities of supervision of third country operators would be undermined is not necessarily valid. The issue of supervision will be addressed in paragraph 4.3 and 4.4.

The field of telecommunication proves that there may be good reasons to apply reverse charging. In 1997 this possibility was enacted for telecommunications through fifteen Council decisions which authorise member states to derogate from Article 9(1). Telecommunication was brought under the reverse charge mechanism to counter price undercutting by foreign telecommunication suppliers who could not be required to impose VAT. Without a reverse charge, business would acquire tax-free benefits by obtaining services from abroad. This would put EU suppliers at a competitive disadvantage.

This example clarifies that the reverse charge mechanism works both ways. On the one hand it prevents price undercutting by country suppliers. On the other hand it facilitates

business to business transactions within the EU. It also enables EU businesses to sell to non-EU customers free of VAT something not available under Article 9(1), which is an important competitive point for telecommunications, and E-commerce. In UNICE's view the Commission should use tax incentives such as this in all relevant areas including E-commerce.

As is said aside from removing the commercial shackles of Article 9(1), the main advantages UNICE sees is that compliance costs related to E-commerce can be decreased considerably for the authorities as well as for the tax payer and registration can sometimes be avoided. Both are necessary for E-commerce to reach its full potential in terms of growth and employment in the EU. Furthermore, the system of reverse charging diminishes the possibilities for VAT fraud. The preamble of the Gold Directive[2] sums up the advantages of the reverse charge mechanism as follows: "Whereas experience has shown that, with regard to most supplies (…) the application of a reverse charge mechanism can help prevent tax fraud while at the same time alleviating the financing charge for the operation (…)."

4.2 Taxation at the place of the supplier

On all E-commerce transactions with non-taxable persons within the EU, VAT should be due where the supplier has established his business, according to the general rule of article 9(1). This implies that the distinction that some countries currently make between 9(2)e, 9(2)c, and 9(1) services has to be abolished. As all transactions with non-taxable persons will be taxed at the place of supplier the selling company will have to prove that the recipient is not a resident of the EU or will have to account for VAT on the sale, as currently is the case. This approach will benefit both business and the Member States. Companies will have to register only once for the whole EU instead of in every Member State that makes a distinction between the services. Governments will gain more possibilities for control as all transactions by a particular supplier can be monitored at the same place of establishment.

This proof of residence outside the EU can be delivered in any way the supplier and the authorities see fit. One way that has been suggested is the use of an electronic signature (ES). The difficulty here is that an electronic signature could indicate from whom a transmission has emanated but will not be evidence of the place of residence or establishment of the transmitter. For instance a person established in the UK could have a mail box in the USA which can be remotely accessed from the UK. Even if it were possible to tag some sort of "foot print" to an electronic signature and use this as evidence difficulties still remain. Every supplier failing to supply a "foot print" proving his recipient's residence outside the EU would have to account for VAT in the EU. Whereas this solution is neutral for EU consumers, a disadvantage is that it hinders sales to private persons outside the EU. International co-ordination would be needed to address this problem.

[2] Directive 98/80/EC

A different approach to proving the recipient's residence outside the EU could be the use of the customer's banking details. As VAT has only to be accounted for on transactions which are paid for the service is always mirrored by a payment from the recipient's bank. If this information is reliable enough, it could very well serve as a means to prove the recipient's residence outside the EU. But again a problem similar to that encountered with electronic signatures arises from the fact that in modern commerce it is not unusual for international businesses to hold bank accounts in countries other than those from which they are trading.

It may be that the most secure way to support a decision whether or not to charge VAT is by non-electronic means as happens currently.

Another issue to address is the difference of definition in places of supply. Currently, not all E-commerce services are deemed to be supplied where the supplier has established his business. The Netherlands for instance have taken the view that E-commerce consisting of amusement or education are services as described in article 9(2)c and therefore deemed to be supplied where the service is enjoyed, i.e. where the recipient has its residence. UNICE is of the opinion that this is not a viable VAT treatment of E-commerce for a number of reasons.

First, it means that the supplier needs to register in each Member State that make the distinction and has to be able to define the location of the recipient in order to know in which Member State the VAT is due. It goes without saying that this will be a major impediment to the development of E-commerce in the EU and will trigger enormous compliance difficulties and costs. Furthermore, as the definitions of services vary between the Member States double and non-taxation are likely to occur. Last but not least it would cause a competitive disadvantage for European businesses as it will mean that they have to register in more than one Member State whereas foreign competitors are not likely to do so. Therefore, taxation at the place of the supplier should be high on the Commission's agenda because to require multiple registrations is to accept that there is no Single Market.

A possible disadvantage of the approach mentioned above is that it might distort competition within the EU, as it tends to favour Member states that apply low VAT rates. A solution might be to set one VAT rate for all E-commerce. UNICE is perfectly aware that this is a politically difficult solution. The issue of harmonisation will be further addressed in paragraph 5.

UNICE is well aware of the fact that taxation at the place of the supplier is a deviation from Implementation Option 17 of the Ottawa conference, but considers it to be a small as well as a necessary departure. Firstly, it is small because all consumption in the EU will be taxed in the EU, although not necessarily in the Member State of consumption, and all consumption outside the EU will not be taxed in the EU. Secondly, it is necessary because enforcing taxation at the place of consumption within the EU will hamper the growth of E-commerce in the EU as it implies that EU suppliers should register in more than one Member State and make a distinction between their different

customers in the EU. Moreover, the creation of multiple points of supply will split supervision up between 15 different fiscal jurisdictions; thus making compliance uncontrollable and unenforceable.

4.3 Single Point of Registration and Reverse charge

The Single Point of Registration (SPR) ties in with both the new telecom rules and the Commission's third option of obliging a 3rd country operator to account for VAT, when supplying to an EU-client. UNICE's proposal is to oblige third country operators to register for VAT, but only once for the whole of the EU and to allow the third country operators (once registered) to use reverse charging. This way, third country operators will be treated in the same way as European businesses, but without the need to establish a physical presence. All transactions will be taxed, whether in the Member State where the recipient has established his business in the case of a business to business transaction or in the Member State where the third country supplier is registered in the case of a transaction with a non-taxable person.

Supervision and compliance will be assured whilst creating a level playing field for both EU and non-EU operators. With regard to compliance burdens the SPR provides equality of treatment between EU and non-EU operators. For as a result of the taxation at the place of supply rule and the reverse charging mechanism EU businesses will have only one place of registration and they will either use the reverse charge mechanism or account for VAT where they have established their business.

The only disadvantage is that this system can create a slight distortion. As is noted in the paragraph 4.2, this system tends to favour Member States applying a low VAT rate. This disadvantage is nevertheless small compared to the problems that not adopting this system would create. Those disadvantaged by the system would be private individuals and businesses which would be unable to fully recover VAT. More comprehensive regulation such as the obligation to register in every Member State will not facilitate supervision or foster compliance, as the costs of compliance will be prohibitive.

Another side effect could be that European businesses might want to move the place from where they supply their services to a Member State applying a lower rate of VAT. Although, telecom has not given proof of such a shift yet. Also, such a shift is not very likely because the VAT rate is only a minor factor in deciding on a possible place of establishment.

4.4 Control and audit issues

In this paragraph some of the primary control and audit issues related to E-commerce will be covered. However, the opening remark on this issue must be that the administrative treatment of E-commerce should not put any additional or unnecessary burden on European business, as this will seriously hamper the development of E-

commerce in the EU. The first part of the paragraph will cover some of the difficulties of controlling and auditing E-commerce, whereas the second part will describe an electronic compliance tool that could be of great help in tracking and controlling E-commerce.

A major challenge in E-commerce is to know both the place of supply and the place consumption. As is indicated in paragraph 4.2, it is possible to use an electronic signature that could make both places visible for VAT purposes. However, EU businesses will suffer a competitive disadvantage if the use of an ES is only required in the EU. Therefore, the use of ES needs to be implemented internationally (or at least within the OECD) before it can be required in the EU. Hence, the Commission needs to put the use of ES on the international agenda.

ES as it stands at the moment is an imperfect tool and would need to be combined with a "foot print". Even then it may make trade with non-EU persons more difficult.

Another question is how to enforce registration by third country operators. For EU suppliers will leave the EU if non EU-suppliers can not be forced to account for VAT. The answer to this problem is twofold. First, VAT compliance must be made easy for foreign suppliers. Secondly, unregistered suppliers must be tracked and penalised.

The SPR could be of considerable value in facilitating compliance by and supervision of foreign suppliers. On the one hand SPR creates an incentive to register because compliance is made easy. On the other hand the SPR makes it easier for the authorities to check whether a supplier is registered because there is only one place of registration. Mutual exchange of information will facilitate checking by fiscal authorities.

Nevertheless there will be opportunities for avoidance, although these will be less than currently is the case. Such avoidance can be tackled, as any third country supplier willing to do business in the EU must make himself visible through the Internet. It will be hard to catch single deals but ongoing business can not remain unnoticed. When discovered the supplier can be dealt with either by way of increased administrative co-operation or through its bank accounts and the payments thereto, although new regulations may be needed to ensure that enforcement action is effective.

Every transaction is mirrored by a payment to the supplier. The supplier needs to provide the recipient's bank with the provider's banking details and the recipient's details. Hence, a potential audit trail is created. The co-operation of banks will only be needed for non-complying suppliers who could not be forced to comply via administrative co-operation. The costs will remain small for banks and could even be visited upon the supplier.

A related problem is that the third country supplier does not necessarily know the location of the recipient and therefore could in theory be unaware of the fact that VAT needs to be accounted for. Although this is not likely to be the case for operators targeting the European market, smaller operators could be unaware of their recipient's

location. This issue can not be addressed by the Community alone but needs to be addressed by the OECD as well. The worldwide use of electronic signatures disclosing residence could be championed by the OECD.

Since 1997, the Member States have taken the view that article 22 of the 6th Directive does not prohibit electronic invoicing if certain conditions are met. In consequence, the Member States were allowed to experiment with systems of Electronic Data Interchange (EDI). So far, the results have been promising. The use of EDI reduces paperwork and compliance costs both for the taxpayer and the authorities. Moreover, the use of EDI is a perfectly controllable system of electronic invoicing.

Electronic invoicing requires that invoicing information is exchanged in a structured way. The structure consists of standards agreed upon in advance. This implies that the data fields have been defined and are dealt with in a consistent sequence. The supplier provides the recipient with an overview of the transactions once every month. The authorities can ask both the supplier and the recipient to reproduce the overviews. As these overviews are stored in a digitised format, this information easily made available and can be sent electronically to the authorities. Confidentiality is safeguarded by the use of public encryption keys[3].

As all information is digitised the overviews are easily compared and audited. Therefore, the EDI system is much more reliable than a system based on the transfer of paper. The European customs system provides a good example of how vast amounts of goods moving through the EU can not be tracked by a control system based on paper. The goods move faster than their paper counterparts can be checked; thus making control physical impossible. As E-commerce moves even faster than tangible goods the need for an electronic invoicing system in this field becomes all the more clear.

To reap the full benefit of EDI, this system must be made available for all intra-community transactions. Otherwise cross-border sales would be treated less favourably than are domestic sales. Moreover, it would enhance the possibilities of controlling intra-community E-commerce. For EDI to be used in intra-community trade the Member States will have to agree on a common standard for electronic invoicing and subsequently adapt their software to this standard.

The use of electronic systems can be expanded even further as the UK Customs have proven. Confronted with the problem described above the UK Customs has decided to allow authorised businesses to submit their import declaration and receive notification of import VAT and duties payable by e-mail. This use of electronic systems can be beneficial both for businesses and authorities as it cuts down compliance costs and enhances the possibilities for tracking and controlling.

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[3] Public encryption keys are the virtual counterparts of the following physical transaction: A sends an open box to B. B puts his message in the box, closes the lid and sends the box back to A. As A has the only key to the box no one but A can open the box. Therefore, transactions protected by a public encryption key are perfectly safe.

5. HARMONISATION

One of the most challenging problems of E-commerce is to answer the question to what extent it will trigger a need for harmonisation. Will harmonisation become inevitable as the VAT boundaries between the Member States become harder to uphold every year? In a virtual marketplace residence is as transient are as the transferred bits, which is one of the main reasons for E-commerce being so hard to tax. Especially in a Single Market differences in VAT treatment and rates can create major distortions, as the supply side of E-commerce is not bound to a physical presence in a Member State. Therefore suppliers will be able to make use of differences in VAT systems.

A more positive way to look at the harmonisation issue is to say that E-commerce creates an incentive to move to the definitive (harmonised) VAT system, thus speeding up the conclusion of the transitional system. The definitive system will for example be based on taxation at origin of the goods and services supplied (Article 35a of the 6th Directive), which is proposed in paragraph 4.2 for E-commerce transactions with non taxable persons established within the EU. In this sense E-commerce could provide an interesting test case for the move to the definitive system. It may be that a single origin system of VAT does not represent a sensible way to proceed.

What kind of harmonisation could be necessary for the VAT treatment of E-commerce? Currently, most aspects of E-commerce are treated differently in the different Member States. These aspects are the definition of services and place of supply, the rates, the treatment of hard copy versus digitised, and compliance. If harmonisation is not feasible then at least some co-ordination must be agreed upon by the Member States.

With regard to services it would be helpful if some agreement could be reached on how to define the different kinds of services on a European basis. Both EU and non-EU suppliers would be helped with simple definitions, especially with regard to compliance and double taxation. At the moment Member States are all devising their own definitions, which could cause the same service to be considered supply of information (article 9(1); taxed where the supplier is located) in one Member State and education (article 9(2)c; taxed where the education is carried out in) in another Member State. This service would than be taxed in both Member States. Furthermore, it can hardly be expected of a non-EU supplier to come to grips with these different definitions. Therefore it could be advisable to treat all E-commerce in the same way and extend Article 9(2)e treatment to all E-commerce supplies.

In this respect the differential treatment of hard copy and services needs to be addressed also. It is acknowledged that differential treatment could appear anomalous not only internally within the EU but also when supplies are being made from outside the Union. In some countries, the sale of hard copies of books is taxed at 6%, whereas the sale of the exact same book in digitised form would be taxed at 17.5%. It goes without saying that this differential treatment could be an impediment to the development of E-commerce.

A different kind of distortion is caused by the difference in VAT rates in the various Member States. As stated above the UNICE option works out in favour of Member States with low rates. However, this distortion can only be prevented by making a (very difficult) distinction between the different kinds of services *and* obliging every supplier, both EU and non-EU, to register for VAT purposes in every Member State. This would create a competitive disadvantage for EU suppliers who can be forced to comply and result in non-compliance for non-EU suppliers whose compliance is hard to enforce. UNICE is well aware of the political sensitivity of aligning VAT rates, but with a view to the argument above feels that this issue needs to be addressed.

Another issue to address is the harmonisation of compliance methods. To create a level playing field for European business compliance must be as light as possible without hampering supervision. A co-ordinated effort in the use of EDI and other electronic compliance methods might very well be necessary. Not only to lower the costs of compliance but also to be able to enforce compliance in a digitised market place. More paperwork will not be an adequate answer although it should be an option if a taxable person so wishes.

From the previous paragraphs it follows that there is quite an argument in favour of more co-ordination in the field of E-commerce. First and foremost, the co-ordination will result in the simplicity needed to further the growth of E-commerce and the Internet economy in Europe. Secondly, simplicity is necessary to enforce compliance both by domestic suppliers and by third country operators. Finally co-ordination may seem essential because as fixed places of establishment are of no importance in the information society suppliers will have infinite choice of residence.

On the other hand there are also some disadvantages to consider. With increased co-ordination comes the risk of harmonisation at the highest level, which could be a competitive disadvantage to European businesses. A disadvantage for Member States could be that harmonisation implies giving up the freedom to set their own VAT rates. As a result the Member States will loose VAT as a macro economic tool to influence spending patterns. In addition the link between a preferred level of public spending and the VAT proceeds needed becomes weaker.

In conclusion it must be said that the disadvantages must not be allowed to outweigh the advantages, especially when it comes to safeguarding the growth potential of E-commerce and enforcing compliance by third country operators. Moreover, harmonisation could to some extent be inevitable considering the volatility of E-commerce. If the conclusion is that harmonisation is needed eventually as E-commerce will not stop growing it might be advisable to consider the consequences in advance, while there is still time to address the different challenges E-commerce poses.

6. HOW IS GOVERNMENT HANDLING E-COMMERCE AT THE MOMENT?

This point is hard to address at the moment, as governments have not taken much action in the field of E-commerce yet. Still UNICE would like to propose a few guidelines:

- taxpayers should not be penalised for any uncertainties;
- government should refrain from enacting complicated legislation;
- governments should refrain from a one-sided approach.

Fairness and open dialogue should be the principles guiding interaction between business and government.

7. CONCLUSION

It is widely agreed that E-commerce poses a major challenge a well as an opportunity to both government and business. Government's task will be to adapt existing regulation including tax laws to this new way of doing business, while the private sector will strive to make the maximum of the opportunities E-commerce offers in terms of both wealth creation and employment. Already 100.000 jobs have been created between 1995 and 1997 and this is only the beginning. Last year the European Commission took up the challenge and indicated that it wished to involve business in the process. UNICE affirms that it is prepared to participate fully.

UNICE's proposal consists of three elements:

1. **Applying the reverse charging for transactions between taxable persons within the EU**, which will facilitate inter company transactions in the EU to the maximum extent possible.
2. **Taxation at the place of establishment of the supplier for transactions with non-taxable persons in the EU**, facilitating both compliance and supervision, because all transactions can be audited at the same place.
3. **Introduction of a Single Point of Registration for third country operators**, making it easier to account for VAT and improving control as all transactions can be monitored by one administration instead of dispersing oversight across Europe.

Implicit in these proposals is the assumption that the development of E-commerce is crucial. Therefore, all efforts must be aimed at ensuring that E-commerce reaches its full potential because the EU already lags behind competing countries, while it is a major driver for growth in terms of the creation of both wealth and employment. This potential must be safeguarded by rules that facilitate the VAT treatment of E-commerce as well as foster control and compliance. UNICE's proposals constitute a considerable step in this direction.

UNICE acknowledges that audit and control mechanisms are a major concern in relation with E-commerce. Control issues centre around taxation of transactions involving third country suppliers and transactions with private individuals. Both the locations of the supplier and the recipient must be known to account for VAT. The use of banking details as well as the use of Electronic Signatures (ES) disclosing residence could be considered, although the

use of ES requires wide international agreement, possibly through the OECD. Regarding audit issues UNICE would like to extend the use of Electronic Data Interchange (EDI). The use of EDI reduces paperwork and compliance costs both for the taxpayer and the authorities and is a perfectly controllable system of electronic invoicing.

UNICE believes that co-ordination will be necessary for two reasons. First, in a virtual marketplace residence is as transient as are the transferred bits. Second, the growth potential of E-commerce must be maximised. Issues that need to be addressed are:

1. **the different VAT treatment by Member States of E-Commerce services**, which can result in double or no taxation;
2. **the differences between the Member States' VAT rates and systems**, which are likely to lead to distortion;
3. **the harmonisation of compliance methods** (ES and EDI) creating a level playing field for European business; a playing field in which compliance is as light as possible without hampering control.

Concluding this paper, UNICE would like to express its willingness to sustain a mutually beneficial discussion with the Commission in exploring the field of E-commerce.

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