

Preface

The introductory chapter of the paper is a synopsis of salient points at issue cardinal to the intellectual basis of the paper, *id est*, the impact of technology on taxation and is VAT the eTax solution? Indeed, it is submitted that the imposition and implication of an eTax on eCommerce in the cyberworld, the formulation of which tax is at once efficient and compliant, is feasible and possible. It is further submitted that VAT, without reconceptualisation or formulation of a new system, is the most effective (actually usable) and practicable solution.

A critical point at issue is rapidly increasing eCommerce transactions and unconstrained amelioration of technology. The issue of an eTax is a compelling field of study because it is both topical and of historical consequence to the extent that the traditional world of tax, commerce and international trade is witnessing the radical evolution of taxation as it rises to meet the unprecedented challenges of eCommerce.

The paper explores the challenge to tax that has thrown the “*application of tax laws into disarray*”.⁴ The point at issue is the marking of “*territory in a seamless digital world . . . of mark[ing] nations and tax jurisdictions in a world that is not based on geography...*”.⁵ It is contended that this challenge pertains primarily to income tax laws to a greater extent than indirect tax laws.

The submission that value-added tax (“VAT”) is the eTax solution is supported by a comparative analysis and application of both income tax principles and VAT to practical examples. It is submitted that such a comparison elucidates VAT’s superior effectiveness and potentiality as an eTax tool in the virtual world. The current escalation of globalisation which in turn has compounded taxation issues has been expedited by the development of the Internet. With the introduction of the Internet and the advent of eCommerce, the traditional concept of international trade

⁴Bird, Richard *Taxing Electronic Commerce: A Revolution in the Making* (September 2003). C.D. Howe Institute Commentary, p4-5. Available at http://www.cdhowe.org/pdf/commentary_187.pdf [Accessed 16/09/2010].

⁵supra.

and commerce can no longer be effectively applied to the new taxing complications and issues manifested by technological amelioration. Unprecedented tax issues in respect of eCommerce transactions in the Internet may be classified as pertaining to the next generation taxing regime. The clumsy attempt to impose “physical world” laws upon a “virtual world” has generated multiple points at issue and has accentuated the impracticability of imposing “physical world” laws on a “virtual world”.

Further to a discussion of tax points at issue and solutions proffered in respect of eCommerce, the eCommerce environment itself and the laws pertaining to such an environment should be examined. Indeed, ignorance of the virtual world and its *modus operandi* precludes competent formulation of effective solutions to points at issue in eCommerce. Acknowledgment of the intricacies and complications of electronic transactions, as well as the continuous evolution of the Internet, will assist in the endeavour to develop a flexible and equitable solution to taxing problems inherent to our new “virtual world”.

Cardinal to the paper is the contention that taxing solutions should not be rigidly tailored to current technology operations and systems. It is essential that proposed tax solutions to all next generation taxing regime issues take cognizance of the current growth rate of electronic technology, that is, taxing solutions to eCommerce should be considered in conjunction with Moore’s Law.⁶ The prevailing tax “challenge” is undoubtedly temporary as it is in the nature of tax to be infinitely adaptable. Taxation is an integral part of human history, past and present, and the virtual world is commerce’s future. It is essential that any taxing system adopted to be imposed upon the virtual world should have the flexibility to be adapted to unpredictable taxing issues precipitated by technological amelioration.

Attempting to enforce a narrow view of tax principles on technology is proving to be increasingly difficult, especially as traditional taxing precepts have fallen victim to the proverbial generation gap and as such are not congruent with contemporary technological concepts of the Y-Generation, particularly with regard to the concept of “physical presence” in the internet. Tax authorities targeting the virtual tax prize may gratify their predilection by espousing the Y-Generation’s philosophy of technology and their concept of being “physically present” in the Internet, which is, furthermore, supported by technology academics.

As the paper is concerned primarily with the analysis and evaluation of VAT as the eTax solution, it is, therefore, imperative to examine some of the inefficiencies of traditional income tax provisions within the eCommerce environment; this relates most significantly to the issues of “residence” and “source” provisions and principles within the income tax analysis. Traditional income tax provisions dismally lack the flexibility to be effectively applied to the virtual world – the

⁶“The ‘law’ was adopted after Intel co-founder Gordon Moore wrote in a 1965 article that the number of transistors on a chip would double every 24 months.” BBC News, Moore’s Law on chips marks 40th (18 April 2005). Available at <http://news.bbc.co.uk/2/hi/technology/4446285.stm> [Accessed 21 July 2009].

theoretical principles upon which traditional income tax is founded are all too often couched in concepts which directly obstruct the necessary adaptability and flexibility of income tax provisions in respect of an ameliorating technological society. The problem of inflexible tax laws is especially pertinent in a society which is still adapting to the concept of being “physically present” within a virtual world. It is, therefore, submitted that current income tax principles are too rigid to adapt sufficiently to the exponentially burgeoning virtual world and technology. Indeed, it may be argued that income tax principles deem that adaptation is the responsibility of technology, the consequences of which are increasingly ineffective application of income tax in eCommerce and increasing loss of tax revenue in respect of government coffers.

The Internet has had a drastic impact on society and, moreover, the economy. It is imperative that we recognise that “*the Internet [is] an important cultural phenomenon . . . [which has, however,] failed to comply with basic economic laws . . . [probably because] it was devised by a bunch of hippie anarchists*”.⁷ Thus, tax authorities should seize the advantage of conceding to the concept that “[t]o get others to come into our way of thinking, we must go over to theirs; and it is necessary to follow, in order to lead”.⁸ Cognizance of the principles and concepts which enmesh the virtual world – the pressing concept of “presence” in the virtual world is a cogent point at issue – is essential to an understanding of the issue of traditional tax principles and virtual world incompatibility. Indeed, a careful scrutiny of the application of income tax principles within the virtual world is significant to the intellectual basis of the paper: “*The impact of technology on taxation*”.

The point at issue is taxation, either direct or indirect, in an eCommerce environment, which is subject to technology and technological concepts, and, as such, it may be proposed that tax adjust its principles and perceptions to those of the technology and communication industry and not demand the reverse. The question begs as to whether the continuing attempt to impose “basic economic laws” on an environment which defies such laws is not in itself a futile exercise. It may be argued that the continuing changes and advancements in technology make such an endeavour a futile exercise, and that the only tax that may possibly work within a “virtual world” may be the imposition of an indirect tax like VAT. The focus of the paper is to highlight the current efficiencies of VAT and consumption taxes in contradistinction to the inefficiencies of income tax principles which have possibly been stretched to their finite point of elasticity. It is submitted that the virtual world, engulfed in its own complications and perplexities, may be more amenable to the application of VAT than to the application of “source-based”, or other income tax, principles.

The issue of countries not implementing a VAT system in respect of eCommerce is a point at issue which posits the challenge as to whether it is possible for VAT

⁷Nolle, Thomas. Available at www.quote garden.com.internet.html [Accessed 8 May 2008].

⁸Shanahan, John M. (Ed). *The Most Brilliant Thoughts of All Times*; Hazlitt, William (1778–1830); Harper Collins, Inc.; New York, USA (1999). p275.

jurisdictions to effectively interact with non-VAT jurisdictions. The inability of VAT jurisdictions to effectively operate in conjunction with retail sales tax jurisdictions would doubtlessly precipitate problematic imposition of indirect taxation within the virtual world. However, a crucial aspect may be that whether a jurisdiction utilises a retail sales tax system or a VAT system, both are indirect taxes. While sales tax may deviate from the principle of neutrality and may not be considered a “general consumption tax”⁹ as is VAT, it is, nevertheless, consumption tax principle based similar to VAT.

While there may be other types of indirect tax systems utilised, VAT and retail sales tax (while the former is more prevalent than the latter) are without a doubt the two prevailing indirect tax systems within the global community. Indeed, 130 jurisdictions currently, as of the year 2010, have adopted and implemented a VAT system. The significant USA jurisdiction utilises a retail sales tax system. Canada, further to this issue, provides a functional example of VAT and retail sales tax co-existing effectively and efficiently in relation to each other, as both VAT and retail sales tax have been implemented in Canada for over 20 years.

eCommerce has not impacted VAT laws to the extent it has income tax laws, but has effectuated an exponential increase in cross-border transactions in respect of which tax laws, depending upon jurisdiction, zero-rate exports and tax imports. Technology has, however, impacted the current retail sales tax systems in effect in the USA instigating an increased urgency to streamline the retail sales tax system. While the paper may not advocate the abandonment of income tax principles in their entirety, comparison of income tax based principles to VAT laws implemented in the various jurisdictions suggests that the virtual world may be more amenable to the application of VAT than to income tax principles. Yet income tax appears to be the primary focus of much research, debate and discussion contingent upon the quantity of tax revenue connected with effective imposition of income tax.

VAT as an effective eTax can be applied to the virtual world in a manner analogous to traditional application precluding administrative difficulties. Inherent to indirect taxes such as VAT, the capacity to expedite eCommerce and facilitate the general operation, management and control of the virtual world is testament to the latter’s potential as an effective eTax tool.

Despite the impact of globalisation on international taxation, disputes pertaining to diverse political agendas predominate most specifically in respect of application of income tax principles. It is not to be implied, however, that indirect taxes such as VAT are insusceptible to disputes extant to conflicting political agendas; however,

⁹Tumpel, Michael, Professor *A Hybrid VAT System in the European Union* (Draft 04/24/2007) p31. Available at http://docs.google.com/viewer?a=v&q=cache:g5ZTN7J6sf8J:www.law.nyu.edu/ideplg?IdcService%3DGET_FILE%26dDocName%3DECM_DLW_013830%26RevisionSelectionMethod%3DLatestReleased+The+common+framework+for+VAT+created+in+1967+for+the+EU&hl=en&pid=bl&srcid=ADGEESig8c6y5AwqvXsSipGHOW8-aslQcrIqfbzM1dwHa6pTbqOQbLX60f8_nx3d-UIY3vjQQg2BR8zYGeVnpGPnM9rt5H2Q4RkiAHe0Pl_tR6xZFjyqhXg0yx3ZcnIdwyatBM51Kdeyp&sig=AHIEtbSZXkC370HMugv4EdOPt6e-bY4eFA&pli=1 [Accessed 14/12/2010].

existing similarities have promoted harmonisation of indirect taxes on account of cross-border transactions. VAT is not without defect and perplexities relative to both the traditional and virtual worlds. VAT is not the “*silver bullet that will solve all the fiscal problems to which the growth of the borderless economy of cyberspace potentially gives rise*”.¹⁰ Further taxation problems arise with the proliferation of eCommerce which may not be effectively resolved with the application of VAT. Thus, while the paper’s primary focus is to evaluate the effectiveness of VAT in regard to collecting taxes on eTransactions, an examination of these issues in terms of finding or exploring a plausible solution is vital for other spheres of taxation, such as transfer pricing.

The submission that VAT is the eCommerce solution is cardinal to the prevailing discourse of the paper. VAT’s attraction is that it is both flexible and adaptable in respect of eCommerce, and in contradistinction to income taxation can be applied to eCommerce without significant change or amendment. However, amendment, radical change and reconceptualisation of income tax provisions are requisite for effective application to the virtual world. Notwithstanding the applicable amendment of relevant general peculiarities of the virtual world which would unequivocally assist in establishing VAT’s capacity as an effective eTax, it is submitted that VAT is, not only in the interim, a dependable eTax in respect of eCommerce, but will remain a powerful taxing tool in the virtual world.

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¹⁰op cit Bird, Richard *Taxing Electronic Commerce: A Revolution in the Making*, p2.

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