

[HTTP://WWW.TAXINGINTERNETTRANSACTIONS.COM](http://www.taxinginternettransactions.com)

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I. INTRODUCTION

No other modern day invention is more fascinating and intriguing than the Internet. With just a single click on the mouse, the world is literally at one's fingertips. Access to different sites from hosts all over the world is gained in a second or even less, one window opening to another and another and still another, boundless, limitless, inexhaustible. It leads to a vast portal of potentialities, defying spatio-temporal limitations known to humankind. The user is immediately transported to a new time zone, an altogether unfamiliar *weltanschauung*, and to a new world order.

In the face of this awesome power comes another power capable of destruction – taxation. Can transactions conducted through the computers be subjected to their corresponding share in defraying the necessary expenses of maintenance?

A. Internet Development in the World

In 1991, the Internet¹ had less than 3 million users around the world and its application to e-commerce was non-existent.² Eight years later, about 250

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¹ The Internet is an international network of interconnected computers, or simply "Interconnected networks." It is the outgrowth of what began in 1969 as a military program called ARPANET designed by the Advanced Research Projects Agency of the U.S. Defense Department to enable computers operated by the military, defense contractors, and universities conducting defense-related research to communicate with one another by redundant channels, even if some portions of the network are damaged in a war. It is a unique and wholly new medium of worldwide human communication. *Reno v. ACLU*, No. 96-511 (US S. Ct. June 26, 1997), available at <http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=us&vol=000&invol=96-511> (last visited Feb 17, 2001 9:46:18 PM).

million users had accessed the Internet and approximately a quarter of them had made online purchases worth more than US\$ 100 billion from various electronic commercial sites. In 2000, there were almost 100 million new users.³ At this rate, e-commerce transactions between businesses (B2B) and between businesses and consumers (B2C) alone in the medium-term accounted for five *per centum* (5%) of intercompany transactions, including supplier-retailer collaboration in the supply chain management,⁴ and retail sales,⁵ respectively.

The Internet is generating so much interest because of the prospects that e-commerce transactions bring in gaining a substantial share of world commerce. It is a borderless technology.⁶ It allows users from one end of the world to access information or download games from a worldwide source.⁷ People converse by means of emails and chat room sites. Other more enterprising individuals seize the opportunity by conducting their trade right through the medium and all its appurtenances. Its open structure and relatively low cost permit the efficient interconnection of extant and new information and communication technologies. Businesses and consumers are faced with a new and powerful information and communication system.⁸ It changes the manner by which goods and services are

² Jonathan Coppel, *E-Commerce: Impacts and Policy Challenges*, Organization for Economic Co-operation and Development at *3 [http://www.oilis.oecd.org/oilis/2000doc.nsf/linkto/ecowkp\(2000\)25](http://www.oilis.oecd.org/oilis/2000doc.nsf/linkto/ecowkp(2000)25) (last visited Feb 14, 2001 12:47:18 AM).

³ *Sweden Remains Top 'Information Economy'*, at <http://www.inq7.net/> (last visited Feb 11, 2001 2:20:42 AM).

⁴ All members of a seamless supply chain act in harmony and as a single unit, not as a number of disparate members crudely brought together. *What is Electronic Commerce?*, at <http://www.ecommerce.ac.uk/ecicr1.html> (last visited Feb 11, 2001 2:20:42 AM).

⁵ The retail level activities that are affected by e-commerce are: sale or lease of goods; provision of services involving banking, health care, and technical advice; sale or licensing of computer software; downloading of entertainment in the form of digitized movies, books, and compact discs (CDs); provision of online information (e.g., LEXIS/NEXIS database); provision of online advertising; gambling; and round-the-clock global trading in all manner of financial instruments. R. L. DOERNBERG & L. HINNEKENS, *ELECTRONIC COMMERCE AND INTERNATIONAL TAXATION* 8 (1999).

⁶ Servers can easily be located anywhere and their location is generally unknown and unimportant in a business transaction. In its current form, it is a triumph of private sector capitalism. These features, which make e-commerce attractive to businesses and consumers, may make e-commerce worrisome for tax authorities that have difficulty identifying transactions and tracing where transactions take place. *Id.* at 7.

⁷ Burnstein, *Conflicts on the Net: Choice of law in Transnational Cyberspace*, 29 VAND. J. TRANSNAT'L L. 80 (1996).

⁸ The effective use of information is the foundation of competitive firms in the millennium. Information and communication technologies (ICTs) have also enlarged the

customized, searched for, distributed, sold or exchanged, and ultimately consumed.⁹

With a single click, contracts are transacted. Undoubtedly, there is a decrease in the cost of conducting business. One no longer has to fly all the way to a foreign jurisdiction or communicate by means of conventional telephony structures. The purchaser, on the other hand, need not remit payment by the means used in ordinary bank-to-bank transactions or through bills of lading. Now, all that needs to be done is for the user to punch in credit card information to consummate the purchase.

E-commerce, in a loose sense, means doing business over the Internet by selling goods and services that are delivered offline or digitized¹⁰ and delivered online, such as computer software, music,¹¹ and other knowledge-intensive products.¹² A consumer may probably visit a local bookstore and inquire about the availability of an out-of-stock book. The bookstore employee downloads a digital copy of the book and prints it along with the cover. This may not be an e-commerce retail transaction, since the agreement to purchase the same has not

competitive environment, made a truly global marketplace, and marked a shift in trade from goods to services. See *What is Electronic Commerce?*, *supra* note 4.

⁹ The Internet is revolutionizing B2B, because it is attacking the inefficiencies in traditional business models by economizing on information and transaction costs, providing better matching of buyers and sellers, lowering prices, and broadening the market. Steven N. Kaplan, *Management Conference: Attacking Inefficiencies in B2B E-Commerce*, at <http://gsbwww.uchicago.edu/news/gsbchicago/sm00/features/conferences.htm> (last visited Feb 11, 2001 2:20:42 AM).

¹⁰ Digitized means the physical form of a good or service can be coded using digital technology and thereby distributed over the Internet. Coppel, *supra* note 2, at *4.

¹¹ A Moving Picture Experts Group (MPEG) Audio Player 3, or MP3, is a common computer file format that compresses audio files far smaller than previously required for CD-quality recordings. The MPEG is a set of standards for audio and video compression established by the Joint ISO/IEC Technical Committee on Information Technology and has different types designed to work in different situations. A minute of music, or several minutes of spoken words, encoded in MP3 require only about one megabyte of disc space, about one-tenth of what the older .wav format required. MP3 has made quick transfer of CD-quality music over the Internet practical. Help Tab of Windows Media Player version 7.00.00.1956 (1992-2000). *A & M Records, Inc. v. Napster, Inc.*, No. 00-16401, Feb 12, 2001 (on file with authors).

¹² In this sense, e-commerce is the application of advanced information technology to increase the effectiveness of business relationships between trading partners. See *What is Electronic Commerce?*, *supra* note 4. It refers to a wide array of commercial activities carried out through the use of computers, including online trading of goods and services, electronic funds transfers, online trading of financial instruments, and electronic data exchanges between companies and within a company. See R. L. Doernberg, *supra* note 5, at 3.

occurred over an electronic network, yet the right to access the digital archived copy is an e-commerce service transaction.¹³ Aside from this simple situation, there is a wider spectrum of commercial activities and information exchanges on the Internet, such as virtual auction markets, that previously did not exist. The website eBay.com,¹⁴ for example, was among the first successful sites to provide a framework where consumers could trade a wide diversity of goods and services with each other (consumer to consumer, or C2C) and, at least in principle, with businesses (consumer to business, or C2B).¹⁵ In 2000, the governments of Australia, the United Kingdom and the United States began to reorganize the management of public procurement systems over the Internet, opening the prospect of sizeable (business to government, or B2G) transactions.¹⁶ The technology is also being used by the governments of other countries for the transmission or receipt of information (government to business, or G2B; government to consumer, or G2C) by consumers for convenience and to lower the cost of payment systems and tax compliance (consumer to government, or C2G), and by businesses to manage post-sales services¹⁷ and develop direct consumer marketing.¹⁸ The academe may be included in any of the sectors, depending on its source of funding and purpose. Below is a matrix of Internet transactions (Table 1), current and common, that illustrate their pervasive impact:

¹³ *Re: Is E-Commerce Ready in the Philippines?* at http://www.esprint.com/_disc1/00000096.htm (last visited Feb 18, 2001 5:54:13PM).

¹⁴ e-bay.com, a flea market auction site, is the most successful company in cyberspace today, controlling eighty *per centum* (80%) of the online auction market, with Yahoo and Amazon lagging far behind and with so many other dotcoms crashing and burning. At the heart of its good fortune is perhaps the most compelling business model on the Internet, for it connects people and does not sell them things. Further, it is not lumbered with a traditional retailing cost structure replete with buying, warehousing, and shipping concerns. The key to its success is its virtuality: by locking up the most buyers and sellers in one place, it creates a market no one could afford to leave. It also has all the lucrative cross-promotional tie-ins with Visa and Mailboxes Etc., and has established in court that it is not liable for the sale of improper items on the site by third parties. Adam Cohen, *eBay's Bid to Conquer All*, TIME, Feb. 5, 2001, at 36.

¹⁵ Coppel, *supra* note 2, at *4.

¹⁶ *Id.*

¹⁷ Information services are sometimes differentiated to appeal to various market segments by offering different levels of quality, such as degree of convenience, more timely and frequent updates, access to technical support, broader coverage, and more sophisticated user interfaces. Coppel, *supra* note 2, at *16.

¹⁸ This may be obtained via "cookies", i.e., a software that enables a website to monitor who is accessing it and for how long. It is possible to assemble a highly-customized database with other purchasing information. However, website monitoring results widely vary depending on the tracking system used. Some websites have even artificially boosted their visitor numbers and, hence, advertised revenue potential by using software programs that provide them with spurious traffic. Coppel, *supra* note 2, at *15.

Table 1. INTERNET TRANSACTIONS

	GOVERNMENT	BUSINESS	CONSUMER
GOVERNMENT	G2G <i>Information</i> <i>coordination</i> <i>cooperation</i>	B2G <i>information</i> <i>procurement</i> <i>payment</i> <i>tax compliance</i>	C2G <i>inquiry</i> <i>payment</i> <i>tax compliance</i>
BUSINESS	G2B <i>Information</i> <i>coordination</i>	B2B <i>Intracompany transaction</i> <i>Intercompany transaction</i> <i>Coordination</i> <i>Collaboration</i>	C2B <i>inquiry</i> <i>payment</i> <i>comparison</i>
CONSUMER	G2C <i>information</i>	B2C <i>sale</i> <i>exchange</i> <i>marketing</i>	C2C <i>sharing</i> <i>transfer</i> <i>auction</i>

Jonathan Coppel, a senior economist in the Director's Office of the Economics Department of the Organization for Economic Cooperation and Development (OECD)¹⁹, notes the difficulty of measuring the expanse of e-commerce.²⁰ Common indicators that can be internationally compared are the numbers of Internet hosts,²¹ secure servers,²² web users, websites, and new domain name²³ registrations. All these imply a very rapid expansion. Disparity among countries and economic regions is also wide. More than ninety *per centum* (90%) of Internet hosts are in OECD countries and, relative to population, English-speaking and Nordic countries generally have the highest density of Internet hosts and secure servers.

¹⁹ The Organisation for Economic Co-operation and Development (OECD) is an international association created pursuant to a Convention signed in Paris on December 14, 1960. It seeks to promote policies designed to achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, and thus contribute to the development of world economy; to contribute to sound economic expansion in member as well as non-member countries in the process of economic development; and to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The following countries became members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996) and Korea (12th December 1996). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention). *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs "Progress in Identifying and Eliminating Harmful Tax Practices"*, at http://www.oecd.org/daf/fa/harm_tax/Report_En.pdf (last visited Feb 19, 2001 2:47:38 PM).

²⁰ Coppel, *supra* note 2, at *5.

²¹ An Internet host is a computer system or device with an Internet Protocol (IP) address connected to the network that can send or receive requests for network services. It includes a computer behind a firewall gateway or special construct that prevents attacks on organizational or corporate network resources originating from the Internet. Surveys that do not capture computers and devices behind firewalls are not capable of properly measuring the size of the Internet. *Id.*

²² A secure server is a computer connected to a network that offers services to other systems on the network. It allows web users to encrypt information on, for instance, credit card data. *Id.*

²³ A domain name locates an organization or other entity on the Internet. <http://www.pmel.org/EC-Glossary.htm> (last visited Feb 18, 2001 5:55:30 PM).

Even more difficult to measure is the value of e-commerce.²⁴ Survey results vary widely due to diverse definitions and scope. Nonetheless, taken together with the Internet-based EDI,²⁵ this value reveals an extremely rapid growth from virtually zero in the mid-1990s to over US\$ 50 billion in 1999 as shown below (Table 2).²⁶ In fact, e-commerce in 2000 has already raked in more than US\$ 110 billion worldwide; seventy-five *per centum* (75%) of these involve buyers and sellers within the United States.²⁷ The biggest chunk, currently accounting seventy to eighty-five *per centum* (70-85%) of electronic sales,²⁸ takes place between businesses.

TABLE 2. CONSULTANT ESTIMATES OF WORLDWIDE E-COMMERCE.

	(in billion US\$)		
	1999	2003	Average Annual Growth
e-Marketer	98.4	1244	89
IDC	111.4	1317	85

²⁴ Coppel, *supra* note 2, at *6.

²⁵ Electronic Data Interchange (EDI) is the application-to-application exchange of routine business information using computers and a telecommunication network in a standard format. The standard format used must be agreed to by the parties exchanging information or selected from a set developed by a recognized standards body like the American National Standards Institute (ANSI X.12), the United Nations-supported EDI for Administrative Commerce and Transport (EDIFACT), or the International Standards Organization (ISO). It is the primary technology used to support electronic commerce. Business information such as purchase orders, quotations, and invoices are exchanged between computers used by cooperating companies. L. FISCHER, *ELECTRONIC COMMERCE: PROFITING FROM BUSINESS ON-LINE 12* (2000).

The EDI developed earlier. It allows for the processing and transmitting of information between computers over private communication networks called value-added networks (VANs). It requires expensive and complex custom software, dedicated communication links, and, in many cases, strictly compatible equipment. The main users are large businesses and their first-tier suppliers. It is now less used, because of its relatively high cost compared with the more flexible and now dominant Transmission Control Protocol/Internet Protocol (TCP/IP) based Internet system. Coppel, *supra* note 2, at *7.

²⁶ *Id.*

²⁷ Rod Nordland, *The Missing "W" on the Web*, NEWSWEEK, Dec. 2000-Feb. 2001, at 68.

²⁸ Coppel, *supra* note 2, at *7.

ActivMedia	95	1324	93
Forrester Low [*]	70	1800	125
Forrester High [*]	170	3200	108
Boston Consulting Group	1000	4600	46

^{*} includes Internet-based EDI

B2B, on the one hand, is expected to progress more quickly than B2C, not only because of the rapid migration from the relatively expensive closed EDI networks to the Internet, but also because of the desire to disintermediate and directly deal with suppliers, thereby lowering purchasing and inventory costs and promoting a more efficient and effective customer service. Transactions usually involve motor vehicles, shipping, chemicals, industrial and high technology equipment, and integration of the supply chain through the Internet. B2C in most sectors, on the other, accounts for only a small percentage of total transactions in selected OECD countries.²⁹ This figure does not even include the use of the Internet as an information source for price and quality comparisons characteristic of C2B.³⁰ The relatively low penetration of B2C is reflected in the typically small value purchases. In other sectors like share trading, there is a substantial level of B2C penetration. In the United States and Europe, this accounts for more than two *per centum* (2%) of equity brokerage services and sales of computer hardware and software, books, music, and videos.³¹ Financial and investment services that can be digitized and delivered over the Internet show a great potential to obtain a large slice of the market.

The business use of the Internet reveals a dichotomy, with substantially higher usage among large companies than small ones and also differing widely depending on the sector in which these are engaged.³² Finance, legal, and other service industries³³ have higher Internet penetration rates than those in

²⁹ *Id.* at *8.

³⁰ By reducing search costs and increasing the flow of information through navigating agents or browsers like Netscape, the Internet may thus effectively shift power from producers to consumers and make it harder for businesses to maintain higher prices. *Id.* at *17.

³¹ *Id.* at *8.

³² *Id.* at *10.

³³ It is also likely that e-commerce will impel widespread changes in the labor market, although the direct employment consequences may not be large, thus shifting the composition

manufacturing and mining. Their main uses of the Internet include accessing commercial databases or services, advertising, ordering goods and services, monitoring prices, and email transactions.

The price of Internet access will continue to change with new and faster access devices penetrating the market and once the local loop³⁴ – one of the main obstacles to cheaper access – of telecommunication networks is liberalized. The advantage for Internet users in countries with unmetered local calls is that they can browse and purchase without being concerned by per minute or per second charges. However, not charging for the duration of network connection can create network congestion problems and even reduce the utility of e-commerce. B2B, in contrast, principally relies on high-speed leased lines that make the Internet very attractive to use.

The speed of data transmission and the extent to which information technology (IT) companies invest in network capacity will influence the future expansion of e-commerce. Investment in information and communication technology (ICT) has strongly risen in virtually all OECD countries. This generates a brisk increase in high capacity, (broad bandwidth³⁵ as in optic fiber and wireless and digital subscriber line (DSL) technologies) at relatively low prices

of workers required to produce and deliver a good or service. A retail sale *via* the Internet probably does not require the same intensity of sales staff, but it requires persons with information technology (IT) skills to develop and program software and to operate and maintain computer servers and networks and persons skilled in graphics design to keep the website attractive and others to dispatch orders. In addition, companies will implement modifications to their production processes in order to exploit the potential of B2B and B2C. *Id.* at *18.

³⁴ The local loop is the last link between the home or office connection and the telephone network. In the past, major telecommunication operators have had a monopoly on the local loop. In 1998 the European Union has decided to liberalize the provision of local voice telephony services and reform access regulations to the local loop infrastructure. In April 2000, the European Commission has adopted a recommendation on full local loop unbundling – allowing elements of the local loop such as switches to be separated and rented by service providers – to be implemented by the end of that year. *Id.* at *12.

³⁵ A bandwidth refers to the amount of data that can be transmitted in a fixed amount of time. For digital devices, it is usually expressed in bits per second (bps) or bytes per second; for analog devices, it is in cycles per second or Hertz (Hz). The bandwidth is particularly important for I/O devices. For example, a fast disk drive can be hampered by a bus with a low bandwidth, for which reason new buses, such as AGP have been developed for the personal computer (PC). <http://e-comm.webopedia.com/TERM/b/bandwidth.html> (last visited Feb 18, 2001 5:55:32).

per unit of capacity. It also enables website stores to enhance their attractiveness and gives household users much faster access than the dial-up modems in use.³⁶

B. Internet Development in the Philippines

Technological advances and their diffusion have stimulated the rapid growth in both the number of persons who use the Internet and its commercial applications.³⁷ Together with economic, legal, and regulatory reforms in the telecommunications sector, these technological innovations have lowered the cost and improved the quality of accessing the Internet.³⁸ Lower computer prices have stimulated their diffusion into most households, although Internet usage did not follow proportionately across countries.

Differences across countries in the number of Internet users relative to population is also affected by telephone access costs. Those countries with more expensive Internet communication costs tend to have a pricing structure where the local call charge comprises a relatively large percentage of total cost.³⁹ These structures, however, are evolving. Many Internet Service Providers (ISPs)⁴⁰ now offer Internet users a fixed number of access hours per month, with local communication charges already included in the subscription price or alternatively,

³⁶ A conventional copper line telephone dial-up, for instance, will require about an hour to merely download a 3.5 minute video file, while a cable or DSL connection will require less than 30 seconds. Coppel, *supra* note 2, at *13.

³⁷ *Id.* at *11.

³⁸ Expected to arrive before the end of 2001 are cell phones that pack the functionality of personal computers (PCs), personal digital assistants (PDAs), and MP3 players; web appliances and access pads that deliver audio and video throughout the home; set-top boxes that become gateway devices or central hubs linking PCs and televisions (TVs) to the outside world; software that monitor corporate websites and automatically fire them up when running out of capacity; peer to peer (P2P) networks that allow individual computers to connect and share information without going through centralized servers; and interplanetary Internet facilities when the moon gets its own node to connect the earth's Internet with spacecraft and other planets. Jennifer L. Schenker, *The New New Things: Technology Will Continue to Shape the Way We Live*, TIME, Feb. 5, 2001, at 54.

³⁹ Coppel, *supra* note 2, at *11.

⁴⁰ An Internet Service Provider provides access to the Internet plus value-added services, such as Website hosting, to individuals and business entities. BIR Rev. Reg. No. __, *Electronic Commerce Transactions*, Exposure Draft, Sec. 1(1.3) (December 17, 2000).

Website hosting allows for a permanent Internet presence without the need to maintain a server or network. Services include front-page server extensions, email forwarding, Post Office Protocol (POP3) email boxes, File Transfer Protocol (FTP) access, Common Gateway Interface (CGI-BIN) access for web-based programs, and hosting support. Website development entails the design and layout of web pages for corporate or personal use.

get remunerated from the telecommunication operators and offer their services at no direct cost to their users.

The limited competition during the early development years of B2C explains the higher prices on the Internet as compared to traditional retailers for identical products. The lower prices now for certain consumer goods found on the Internet reflects the intense competition between B2C companies to establish market share and brand name recognition.⁴¹

The Philippines connected to the Internet in March 1994, when the Philnet Foundation, a consortium of leading Philippine universities and the Department of Science and Technology, established a domestic data communications infrastructure and a connection to SprintNet in California.⁴² Despite the passage of seven years since then, e-commerce awareness level in the country is not yet mature. Although a powerful trade/business tool, e-commerce has not reached a critical mass to ensure competitive advantages and long-term viability. It is still in its infancy stage.⁴³

II. REVIEW AND ASSESSMENT OF PHILIPPINE TAX RULES AND THEIR EFFECTS ON INTERNET TRANSACTIONS

A review and assessment of traditional tax principles in the Philippines should be made before evaluating alternative approaches or policies to transactions involving Internet applications.

A neutral tax policy generally should not seek to favor or specially burden any one commercial activity; it should not discriminate.⁴⁴ This is the tested notion that an even-handed taxation yields the best economic results for the public. In addition, tax laws should be clearly articulated or transparent so that the

⁴¹ Coppel, *supra* note 2, at *14.

⁴² Charles E. Gardner, *The Internet and the Philippines*, at <http://www.cyberbayan.org/philnet/InternetPhil.html> (last visited Feb 18, 2001 6:06:20 PM).

⁴³ E-mail from Vicky Lim-Tan, Senior Financial Analyst, Asian Development Bank, to authors (February 9, 2001 6:06:20PM) (on file with the authors).

⁴⁴ "If I'm So Empowered, Why Do I Need You?": *Defining Government's Role in Internet Electronic Commerce*, Report of the Electronic Commerce Advisory Council, California, (November 1998), at http://www.e-commerce.ca.gov/ld_tax.html (last visited Feb 11, 2001 2:20:42 AM).

taxpayers can know in advance what taxes will be due on a particular economic activity.⁴⁵

It is important to taxpayers that compliance with tax laws be as easy and inexpensive as possible.⁴⁶ These attributes are important to the government, because a streamlined system will cost less to administer and, in fact, encourage taxpayer compliance.

The policy goals of tax reform appear to match the very principles upon which tax systems are structured. The OECD has enunciated and reaffirmed in January 2000 these principles in the context of responding to the tax system challenges of e-commerce and the new technologies. In its October 1998 "Taxation Framework Principles for Taxation and Electronic Commerce," the OECD has already endorsed neutrality, efficiency, certainty, simplicity, effectiveness, fairness, and flexibility as the taxation principles that should guide governments in conventional and e-commerce. Tax reform aims to bring the tax system closer to the ideal represented by these principles.⁴⁷ It is no different than its past in terms of principles. But the future of tax reform is different to this extent: the tools to achieve the basic principles must change to reflect the globalization of commerce. Tax administrators will need an unprecedented degree of international cooperation to accomplish such objective.

There are a number of issues about taxation and tax policy as applied to Internet transactions. Concerns have been expressed that e-commerce will result in eroding tax bases and undermining the application of national tax laws. Take, for example, the problem of consumption taxes. These are normally levied at the place of consumption and according to rates set in individual countries or in individual states in the case of federal nations. Under Value Added Tax (VAT) systems in the case of B2C however, the supplier that is normally responsible for collecting consumption taxes may have limited means to prove the location of its customers and may also be beyond the fiscal jurisdiction of the fiscal authorities where consumption takes place. In practice, this problem appears more acute for goods and services that can be digitized and delivered online. Regarding potential tax loss related to physical goods traded across borders, but ordered over the Internet, many countries have a *de minimis* tax relief for low value transactions,

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ Frances M. Horner, *The OECD, Tax Competition, and the Future of Tax Reform*, Organisation for Economic Co-operation and Development, at <http://www.oecd.org/daf/FSM/taxcompetitionarticle.html> (last visited Feb 8, 2001 3:20:53 AM).

whereby when below the value threshold, these goods legitimately fall outside the tax net. Emerging issues here are the need to minimize distortion to competition and to find the right balance between the cost of collection and the amount of foregone taxes. Given the present size of e-commerce, serious erosion of the tax base is not in prospect. In the future, however, it may become more of an issue for tax authorities.⁴⁸

Countless pesos, for instance, in the form of tax money is being lost with every transaction coursed through the Internet, for the same is not reduced in writing. Physical receipts evidencing acceptance are in fact not issued. In 1997 alone, it has been reported that Filipinos comprising six *per centum* (6%) of those with access to the Internet have purchased goods and services online in an amount reaching US\$ 1.6 million.⁴⁹ With the proliferation of ISPs and the introduction of prepaid Internet cards, it is believed that by 2002, thirty *per centum* (30%) of those with access will purchase some US\$ 386.66 million worth of online goods and services.⁵⁰ If the inability to tax the same continues for an extended period of time, it will not be surprising if the deficit should increase.

Multinational corporations are certainly not new, but they are now operating in new ways that exacerbate already complex tax determinations.⁵¹ For instance, just-in-time⁵² processing has inspired many businesses to source components close-by. But when a component is a new software application to be released with a soon-to-be-shipped item, a manufacturer can source it from any one of its subsidiaries or in part from all. Thus, from one item, various tax laws must be consulted, cross-referenced, and reconciled.

Technology and new management models for sourcing, manufacturing, and distribution are making it tougher to apply existing property, consumption, and income tax laws. The same technology and management models are also making it easier for businesses to abandon states and countries that take excessive

⁴⁸ Coppel, *supra* note 2, at *17.

⁴⁹ *RP Internet Users: 217,000 and Rising*, COMPUTERWORLD-PHILIPPINES, Oct. 15, 1998, at 1.

⁵⁰ E. C. LALLANA, R. N. S. QUIMBO, & L. C. SALAZAR, BUSINESS@PHILIPPINES.COM: ELECTRONIC COMMERCE POLICY ISSUES IN THE PHILIPPINES 2 (1999).

⁵¹ "If I'm So Empowered, Why Do I Need You?": Defining Government's Role in Internet Electronic Commerce, *supra* note 45.

⁵² Just-in-time is a philosophy centered on the reduction of costs through elimination of inventory. All materials and components should arrive at a workstation when needed – no earlier and no later. L. H. HAMMER, W. K. CARTER, & M. F. USRY, COST ACCOUNTING 240 (11th ed. 1994).

or heavy-handed approaches when crafting new tax regimes or applying old ones. Governments must develop approaches that will resolve the growing complexities, but not by fitting new business models into old frameworks. States should not look for independent solutions based on Internet-specific tax regimes. Top-down preemption is not the right approach, but rather, a national policy should be implemented at all levels of government.⁵³

The technology, however, also provides opportunities for tax authorities in C2G and B2G to improve the efficiency of tax administration and to enhance taxpayer service. Communication and easy access to information encourages voluntary compliance with tax obligations. The Internet facilitates the electronic assessment, filing, and collection of taxes,⁵⁴ although to date, the Bureau of Internal Revenue (BIR) website only has information regarding its top officials, selected tax forms in PKZIP format,⁵⁵ the Tax Code, and downloadable zonal valuation.⁵⁶

In June 2000, Republic Act No. 8792, otherwise known as the Electronic Commerce Act, took effect in the Philippines. There is however no specific provision that directly provides for the taxation of Internet transactions. There is only a general mandate⁵⁷ for the use by the government of electronic data messages, electronic documents, and electronic signatures; the installation of an electronic online network, otherwise known as RPWEB, to implement this mandate; and the authority of the Department of Trade and Industry to direct and supervise the promotion and development of e-commerce with relevant government agencies, without prejudice to the provisions of Republic Act No. 7653 and Republic Act No. 337, as amended.⁵⁸ In the BIR, the latest project is the Automated Data Capture System (ADCS) that tackles e-filing and e-payments but not the taxation of Internet transactions.⁵⁹

⁵³ "If I'm So Empowered, Why Do I Need You?": *Defining Government's Role in Internet Electronic Commerce*, *supra* note 44.

⁵⁴ Coppel, *supra* note 2, at *17.

⁵⁵ A file extension for files catalogued and compressed using PKZIP compression utilities intended for faster downloading.

⁵⁶ <http://www.bir.gov.ph> (last visited Feb 18, 2001 8:32:19 PM).

⁵⁷ REP. ACT NO. 8792 (2000), sec. 27-29.

⁵⁸ REPUBLIC ACT 7653 is "The New Central Bank Act" which was approved on June 14, 1993, while REPUBLIC ACT 337 is "The General Banking Act" approved on July 24, 1948. The latter law has been modified by REPUBLIC ACT 8791, otherwise known as "The General Banking Law of 2000," approved on May 23, 2000.

⁵⁹ Interview with Atty. Alma Barcelo, technical assistant of the Legal Service and Inspection Group, BIR. (February 2, 2001).

To date, there are no explicit Philippine tax laws on e-commerce.⁶⁰ It appears that no law will be passed on the subject in the near future.⁶¹ However, it cannot be denied that many electronic transactions and entities are subject to existing tax laws. The challenge to the BIR is to meet this new and ever-widening technology, apart from its initial participation in the Inter-Agency Task Force that drafted the Act's Implementing Rules and Regulations (IRR).

The BIR at present has not issued any regulations regarding e-commerce. Without any set of guidelines and a clear-cut understanding of the matter, it is difficult to predict how the BIR will manage to enforce the relevant tax provisions in respect of e-commerce. It is reasonable to assume that until such time as pertinent legislation is introduced in the Philippines, e-commerce may very well continue unrestricted and unimpeded by any form of taxation.⁶² In line with the mandate declared in Section 27 of Republic Act No. 8792, however, the BIR must not only establish the acceptability of electronic records, dispensing with the mandatory production of paper records, but must also issue guidelines that ensure their physical integrity.⁶³ This requires the further amendment of Revenue Regulations No. V-1, as amended, otherwise known as the Bookkeeping Regulations, issued pursuant to Commonwealth Act No. 466, and the online Taxpayer's Bill of Rights regarding physical books of accounts.⁶⁴ It is curious to note that this mandate gives a leeway in that with the appropriate public hearings and publication requirements,⁶⁵ the two (2) year period may not be met in full.

Since the Internet may be likened to a telephone, as one practically is able to communicate *via* email, the fundamental issue raised is whether it is actually a public utility,⁶⁶ and if such, whether it falls under the Constitutional mandate that a legislative franchise⁶⁷ is needed before one may operate a utility.⁶⁸

⁶⁰ Interview with Juan Chua, President, Nexus Technologies, Inc. (January 2001).

⁶¹ J. M. DISINI, JR., "THE ELECTRONIC COMMERCE ACT" AND ITS IMPLEMENTING RULES AND REGULATIONS 10 (2000).

⁶² Christopher Lim, *Enforcement and Monitoring of Electronic Commerce*, at http://www.bakerinfo.com/apec/philapecc_main.htm#enforcement (last visited Feb 8, 2001 3:20:53 AM).

⁶³ E. C. Lallana, *supra* note 50, at 47.

⁶⁴ http://www.bir.gov.ph/fyi_tpbil.html (last visited Feb 16, 2001 4:33:33).

⁶⁵ REP. ACT NO. 8792 (2000), sec. 27 (d).

⁶⁶ A public utility is a business or service engaged in regularly supplying the public with some commodity or service of public consequence, such as electricity, gas, water, transportation, telephone, or telegraph service. 64 AM. JUR. 2D § 1 (1972).

⁶⁷ Franchises issued by Congress are not required before each and every public utility may operate. Thus, the law has granted certain administrative agencies the power to grant licenses

The definition given by the law applies squarely as it includes wire or wireless communication.⁶⁹ Also to be considered is the nationality requirement for industry players engaged in mass media⁷⁰ and the concomitant application of tax rules.

Another issue is whether the Internet transaction involving B2C will actually constitute a retail of goods.⁷¹ If so, will it be a violation of the Retail Trade Liberalization Act of 2000? This puts to concern the status of the industry player for income tax purposes.

If the seller is a foreign entity and, therefore, with a *situs* outside the Philippines, and the buyer is a resident citizen, then it can be said that there actually exists an importation, since the goods delivered into the country will have to pass through Customs inspection and the corresponding tariffs and duties collected.⁷² But then, there is doubt whether digitized items can still be considered importation. The act of downloading may be considered as sourcing from a foreign *situs*, but what if the website from which the same is sourced is actually hosted within the local taxing jurisdiction, together with the fact that the buyer never even left the confines of the home to purchase the good or service?

Digitized goods and services blur the concept of geographical boundaries, such as place of supply or residence. Since trade policy – like tax policy – is based on such distinctions, governments may find it difficult to determine jurisdiction

for or to authorize the operation of certain public utilities. *Albano v. Reyes*, G.R. No. 83551, July 11, 1989.

⁶⁸ CONST. art. XII, sec. 11.

⁶⁹ The Public Service Law provides that the term public service includes every person that now or hereafter may own, operate, manage, or control in the Philippines, for hire or compensation, with general or limited clientele, whether permanent, occasional or accidental, and done for general business purposes, any common carrier, railroad, street railway, traction railway, sub-way motor vehicle, either for freight or passenger, or both with or without fixed route and whatever may be its classification, freight or carrier service of any class, express service, steamboat, or steamship line, pontines, ferries, and water craft, engaged in the transportation of passengers and freight or both, shipyard, marine railway, refrigeration plant, canal, irrigation system, gas, electric light, heat and power, water supply and power, petroleum, sewerage system, wire or wireless communications system, wire or wireless broadcasting stations and other similar public services. COM. ACT NO. 146 (1936), sec. 13 (b).

⁷⁰ CONST. art XVI, sec. 11(1).

⁷¹ REP. ACT NO. 8762 (2000), sec. 3.

⁷² Interviews with Atty. Edwin R. Abella, Chief of the Tax Fraud Division, BIR and Girlie Valenzuela, Supervisor of the Tax Fraud Division and technical assistant for the Regulation Committee (February 2, 2001).

and tariff rights.⁷³ Besides, the laws and implementing rules and regulations a consumer relies on for protection at the municipal level may not be applicable in the supplier's country. There are some concerns, indeed, that the extent to which the Internet transcends national boundaries may even render powerless the ability of regulatory bodies to fulfill their mandated objectives. Therefore, it is imperative to update or upgrade regulatory frameworks and mechanisms and strengthen cooperation between these regulatory bodies in G2G to implement macroeconomic policies and achieve the goals of economic regulations, without putting at risk the efficiencies of e-commerce.

In American jurisprudence, the concept of sales tax is applied. It is imposed in order to put the local seller with an interstate seller on equal footing. In order to tax such a seller, due process must be observed.⁷⁴ It has been interpreted to mean that there should at least be the presence of minimum contacts before a state may exercise personal jurisdiction over a nonresident party.⁷⁵ In *State of Wisconsin v. JC Penny Co.*,⁷⁶ a US Case, the US Supreme Court held that "the taxing power exerted by the State should bear a fiscal relation to protection, opportunities, and benefits given by the State." Such a standard was later abandoned in the case of *National Bellas Hess, Inc. v. Department of Revenue of State of Illinois*,⁷⁷ when the Court refused to rely on the minimum contact of catalogue mailing to Illinois Customers and instead took consideration of the fact that National Bellas Hess, Inc. actually was incorporated in Delaware with its principal place of business in Missouri.

Although of merely persuasive effect, the interpretation in the United States of tax laws from which ours have been chiefly patterned can serve as guideposts for future regulations. In *Complete Auto Transit Inc., v. Brady*,⁷⁸ the Court likewise held that before a use tax may be imposed, there should be compliance with the *Four-Part Test*, to wit: 1) the seller's activity has a substantial nexus with the taxing state; 2) the tax is fairly apportioned; 3) it is non-discriminatory; and 4) it is related to services provided by the taxing state to the seller. By using the term "substantial nexus" it was meant that "a party must have

⁷³ Coppel, *supra* note 2, at *18.

⁷⁴ GRAVES, *Physical Presence in Cyberspace: As Electronic Commerce Takes Off, Does Quill Leave Local Merchants in the Dust?*, 37 DUQUESNE L. REV. 268 (1999).

⁷⁵ *Id.*

⁷⁶ 311 U.S. 435 (1941).

⁷⁷ 386 U.S. 753 (1967).

⁷⁸ 430 U.S. 274 (1977).

physical presence and that it owns property, maintains retail store or station employees within the taxing state."

In many ways, the Internet is likened to the sending of catalogues to customers, but that it is only posted and viewed through a browser and not physically delivered. The seller often does not maintain any office or agent in the country where the "catalogue" is being accessed. If we were to apply the same standards in the Complete Auto and Quills cases, then certainly a seller not found within may not be taxed. This is in line with the general principle of territoriality of the power to tax.⁷⁹ The foreign seller should at least have an agent or employee in our taxing jurisdiction.

Criticisms have thus been hurled against the physical presence rule, the reason being that since technological advances have made physical presence within the taxing jurisdiction meaningless in modern commerce.⁸⁰ Instead of this rule, it has been suggested that economic presence, its functional equivalent, be the controlling standard. This would refer to the seller's performance of extensive, continuous, and intentional solicitation.⁸¹ Factors like market base, gross sales, and volume of sales should be considered.⁸² It would seem that this standard is more appropriate at this time.

The World Trade Organization (WTO)⁸³ has begun to address some of these issues.⁸⁴ The approach adopted has been to consider e-commerce as another medium for exchange and thus subject to the same rules and regulations as conventional transactions – the principle of equivalent treatment.⁸⁵ Without prejudice to the outcome of the comprehensive work *programme* to be established by the General Council or the rights and obligations of members under the WTO

⁷⁹ HECTOR S. DE LEON, *THE FUNDAMENTALS OF TAXATION* 3 (12th ed., 1998).

⁸⁰ *Heitkamp v. Quill Corp.*, 470 N. W. 2d 203, 216 (N. D. 1991).

⁸¹ *Id.* at 212.

⁸² *Graves*, *supra* note 74, at 268.

⁸³ The WTO, established on January 1, 1995, is the embodiment of the Uruguay Round results and the successor to the General Agreement on Tariffs and Trade (GATT). The latter applied only to trade in merchandise goods; the former covers trade in goods, services, and trade in ideas or intellectual property. The WTO is now the legal and institutional foundation of the multilateral trading system. It provides the principal contractual obligations in determining how governments frame and implement domestic trade legislation and regulations. See R.B. RODRIGUEZ, *THE GATT AND THE WHO: AN INTRODUCTION* 70-1 (1998).

⁸⁴ http://www.wto.org/english/tratop_e/ecom_e/ecom_e.htm (last visited Feb 18, 2001 9:29:35 PM).

⁸⁵ *Coppel*, *supra* note 2, at *18.

Agreements, the members have adopted on May 20, 1998 a Declaration on Global Electronic Commerce⁸⁶ to continue their current practice of not imposing customs duties on electronic transmissions. Even without this temporary moratorium, there has always been an uncertain application of existing customs duties. B2C purchasers are hardly *au fait* about customs duties and charges, while their suppliers find it hard to make available information on cross-border customs regulations.⁸⁷ Most of the time, the purchaser is in doubt as to the final cost and experiences delivery delays as the goods ordered over the Internet are held until customs clearance is obtained. The World Customs Organization (WCO)⁸⁸ has worked on these problems and has advocated procedures for simplified customs clearance, information technology requirements, and guidelines for greater transparency.⁸⁹

Sharp increases in equity prices, especially of Internet stocks, have occurred in expectation of faster future growth in output and profits.⁹⁰ Together with a cheaper cost of capital, they boost investment.⁹¹ The cyclical nature of economies and how payments are made are likewise modified. These have implications on the setting and operation of monetary policy.⁹² E-cash systems,

⁸⁶ Available at http://www.wto.org/english/tratop_e/ecom_e/mindecl_e.htm (last visited Feb 18, 2001 9:30:17 PM).

⁸⁷ Forrester, an Internet research consultancy, has estimated in 2000 that eighty-five *per centum* (85%) of online companies are incapable of shipping across borders. In fact most e-commerce transactions are within borders. A Boston Consulting Group report in 1999 has also disclosed that online exports beyond European borders account for only seven *per centum* (7%) of their retailers' revenues. Coppel, *supra* note 2, at *18.

⁸⁸ Established in 1952 as the Customs Co-operation Council, the WCO is an independent inter-governmental body whose mission is to enhance the effectiveness and efficiency of customs administration. With 151 member governments, it is the only inter-governmental worldwide organization competent in customs matters. <http://www.wcoomd.org/frmpublic.htm> (last visited Feb 18, 2001 10:57:12 PM).

⁸⁹ Coppel, *supra* note 2, at *18.

⁹⁰ *Id.* at *19.

⁹¹ Online stock trading is increasing by one hundred fifty *per centum* (150%) annually. As the public grows more comfortable with online trading of stocks and mutual funds, the popularity of online financial services will increase. The new paradigm is that everyone has access to electronic advice and most of the advice is free. Austan D. Goolsbee, Dennis Chookaszian, and Todd Ricketts, *The Future of Finance, Technology, and Financial Services*, at <http://gsbwww.uchicago.edu/news/gsbchicago/sm00/features/conferences.htm> (last visited Feb 11, 2001 2:20:42 AM).

⁹² E-commerce facilitates more efficient stock management, leading to lower inventory ratios [inventory as a percentage of total assets or total sales] or turnovers [cost of sales divided by average inventory] and possibly also modifying the stockpiling cycle. See J.C. VAN HORNE,

such as stored-value cards (SVCs) and network money⁹³ are more likely to develop without supplanting central and independent monetary authorities at the municipal level. Initial surveys, however, indicate that these systems have so far failed to gain a sizeable share of the payments system. Most Internet purchases are still made by credit card, even though web users are already concerned about the potential for fraud and would prefer to use a more secure payment method. E-cash has shown limited appeal for two reasons, namely: (1) the substantial costs involved in setting up the necessary facilities and (2) the lack of public acceptance brought about by security and privacy concerns, since these systems can keep track of what web users purchase. If e-cash providers manage to deal with safety and anonymity issues, the potential for its widespread introduction will be considerably enhanced.⁹⁴

In the Philippines, the idea of electronic wallets where money resides in the network of the telephone operator is now being stretched to SVCs that work at least for select retail shops in the major cities.⁹⁵ Subscribers, for instance, used

FINANCIAL MANAGEMENT AND POLICY 721 (5th ed., 1980) and J.M. SMITH & K. FRED SKOUSEN, INTERMEDIATE ACCOUNTING 1052 (11th ed., 1992).

In addition, increased price competition in product markets may allow the economy to sustain more jobs without stoking inflation for a period of time and also put greater pressure on companies to curb wage growth and modify the process-generating inflation and thereby the cyclical responsiveness of inflation. It has been argued that Internet related technologies can increase the speed of financial operations, thus raising the issue as to how interest rates should be set and whether the short end of interest setting needs to become shorter, *i.e.* in time units smaller than a day. Some economists have even envisaged a world where technological developments weaken altogether the monetary controls of central banks. This could occur if new technologies and regulators permitted real time pricing and exchange of goods or services across the Internet without the intercession of an independent monetary authority. In such an environment, the government earns no seignorage and will no longer be able to provide liquidity support by printing money. Coppel, *supra* note 2, at *20.

⁹³ SVCs are funds stored in electronic form and can be used to make payments at participating merchants and potentially to all other holders of such a card. Once the stored funds have been used, the card can be recharged.

Network money refers to funds that are stored on an electronic device, such as a computer hard drive and transferred over communication networks such as the Internet.

SVCs are likely to be substitutes for currency and network money for deposits. *Ibid.*

⁹⁴ In the event that e-cash starts to gain a large part of the payments system, its close substitutability with other payment instruments will raise concerns about the definition of monetary aggregates, their stability, the ability of central banks to control monetary supply and accrue seignorage revenues, and the possibility of heightened money laundering. Coppel, *supra* note 2, at *21.

⁹⁵ Erwin Lemuel G. Oliva, *From Electronic Wallets to Virtual Gift Certificates*, at <http://www.inq7.net/> (last visited Feb 11, 2001 2:20:42 AM).

to store Smart Money by opening an account with First e-Bank. When a purchase is made, the user is prompted to key in a personal identification number (PIN) to authenticate the transaction and ensure its security. Now, prepaid subscribers can reload money into their accounts, do mobile banking, and even pay bills. By the second quarter of 2001, other banks that belonged to the network's mobile banking service *via* Short Message Service (SMS) or text messaging became dealers of the SVCs. Expansion to the World Wide Web (WWW) for this type of service is not far behind at least for local merchants. Automated Teller Machine (ATM)⁹⁶ cards will be debit cards for online purchases.

Incoherence in the relevance of national borders for trade purposes compels an examination of tax reform from a global perspective, for the same incoherence allows harmful tax practices to thrive.⁹⁷ Though cross-border barriers to trade have dropped, the funding of public services remains largely a sovereign affair. National governments are responsible for providing public services within their own borders, namely: national security, infrastructure, and social benefits mainly financed by various forms of taxation. Taxes are imposed upon those who reside within the national borders and upon those who are the beneficiaries of the economic stability of the nation. The coincidence of national tax with global trade increases the risk that the beneficiaries of a country's stability, infrastructure, and public services will be able to exploit the capital mobility to evade paying their proper share of that country's taxes. Without steps to protect the integrity of tax systems, governments may find it difficult to take forward the liberalization of cross-border trade or to reduce public services, including those that support international commerce. In either case, the threat to integrated global commerce is real and significant. The opportunists in these schemes are well-advised taxpayers who are able to evade taxation on large amounts of income while enjoying the benefits of public services being paid for by other taxpayers not choosing to take advantage of similar predatory schemes. This degradation of the tax base leads inevitably to higher effective tax rates for honest taxpayers, ever-widening loopholes for tax evaders, and increasing complexities for taxpayers and tax administrators.

⁹⁶ ATM cards may be used in online purchases to automatically debit funds from accounts maintained in participating banks. These may be used in unattended electronic machines found in public places, connected to data systems and related equipments, and activated by the bank's customer. <http://www.bartleby.com/61/72/A0537200.html> (last visited Feb 18, 2001 6:10:47 PM).

⁹⁷ Horner, *supra* note 47.

The OECD addresses *harmful* tax competition, not *all* tax competition.⁹⁸ The harmonization paradox is that harmful tax competition actually reduces fiscal sovereignty. The paradox can force a *de facto* harmonization of direct taxes at a no or nominal rate and a shift from direct to consumption taxes. If harmful tax competition is ended, governments will remain free to make their own fair decisions about what tax system they wish to offer.

The fight against harmful tax competition⁹⁹ is the future of tax reform. It is not a fight against lower tax rates. A country must be able to choose what level of public services it wishes to provide and set its tax rates accordingly. Businesses must then be free to relocate if they prefer lower tax rates, *e.g.* at the cost of a lower level of public services or because the government simply operates more efficiently. Such an approach leads to healthy competition.

Harmful tax schemes work principally by limiting the availability of information about the existence or amount of offshore investments,¹⁰⁰ particularly those in foreign currencies. Such schemes give a non-resident beneficial owner of income an opportunity to place the same in a tax-free environment that facilitates non-reporting to the beneficial owner's country of residence. They arise in a jurisdiction that has no income tax system – commonly referred to as a tax

⁹⁸ Its goals are much like those of the base-broadening, rate reducing tax reforms of the 1980's: to eliminate advantages available only to the well-advised taxpayers, to simplify systems by reducing loopholes, and to move more closely to a level playing field for business and governments. *Id.*

⁹⁹ Holding companies and similar preferential tax regimes are not included, although they may constitute harmful tax competition. The OECD has been presented with a number of these and similar provisions, but in light of the complexities raised by such regimes, including their possible interaction with tax treaties and generally applicable principles of domestic law, it has reached no conclusions regarding their status as potentially harmful preferential regimes. Currently, the following countries are being examined: Austria, Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Luxembourg, Netherlands, Portugal, Spain, and Switzerland. See *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs* "Progress in Identifying and Eliminating Harmful Tax Practices", *supra* note 19, at *15.

¹⁰⁰ It is difficult to estimate the amount of tax revenues that are being lost due to tax poaching. Because predatory tax practices generally operate by means of concealing information about income flows, economic measures of those flows must be extrapolated from limited data. The irony in OECD estimates is that, while residence countries may be losing billions of U.S. dollars each year from predatory tax practices, the jurisdictions that carry on such practices receive only the smallest fraction of that amount, in the guise of fees for offshore licenses, and perhaps from an increase in occupations that support the offshore industry. Horner, *supra* note 47.

haven¹⁰¹ – and in the context of a jurisdiction that has a general income tax accompanied by preferential regimes that exempt from taxation or reduce tax rates on offshore income. A low/no/nominal tax rate alone should not be seen as constituting unfair tax competition under the OECD. Predatory tax practices may exist when a low/no/nominal tax rate is combined with other *indicia* that point out a jurisdiction's regimes presenting significant obstacles to a home country's ability to enforce its own tax laws.

Globalization¹⁰² and new electronic technologies can encourage the proliferation of harmful tax practices. Governments must intensify international cooperation, protect their tax bases, and avoid worldwide reduction in welfare caused by tax-induced distortions in capital and financial flows.¹⁰³

As early as 1996, OECD governments had already initiated a project on harmful tax schemes. That project has led to the adoption by the OECD Council on April 9, 1998,¹⁰⁴ with abstentions from Luxembourg and Switzerland, of a Report and Guidelines on harmful tax practices.¹⁰⁵ It concludes that tax competition is harmful, unless it is transparent, non-discriminatory, and aimed at

¹⁰¹ A tax haven is a jurisdiction that meets the criteria for harmful tax practices set by the OECD and either has a no/nominal tax system or has preferential regimes that are so significant and pervasive that the no/nominally taxed offshore sector dominates the jurisdiction's economy. The OECD recognizes in this regard the vast opportunities for tax poaching. The ease with which capital can be relocated has encouraged the proliferation of preferential tax regimes and tax haven jurisdictions, all competing to attract the mobile components of a multinational company, *i.e.*, its headquarters, sales, financing, and other activities. It is in this context that the OECD work is taking place. *Id.*

¹⁰² Globalization is the process by which nationality becomes increasingly irrelevant. It may be one of consumption, *i.e.*, the nation in which a product was made becomes independent of the nationality of the consumer, or of production or ownership, *i.e.*, the nationality of the owner and controller of productive assets is independent of the nation housing them. <http://pacific.commerce.ubc.ca/keith/Lectures/mne2.html> (last visited Feb 18, 2001 5:55:30 PM).

¹⁰³ Jeffrey Owens, *Harmful Tax Practices*, at http://www.oecd.org/daf/fa/harm_tax/harmtax.htm (last visited Feb 8, 2001 3:20:53 AM).

¹⁰⁴ *Harmful Tax Competition: An Emerging Global Issue*, at http://www.oecd.org/daf/fa/harm_tax/Report_En.pdf (last visited Feb 19, 2001 2:47:38 PM).

¹⁰⁵ Harmful tax practices may exist when regimes are tailored to erode the tax base of other countries. This can occur when tax regimes attract investment or savings originating elsewhere and when they facilitate the residents legally escaping tax due in their home country. Owens, *supra* note 103.

attracting real activities, not just facilitating tax minimization strategies or tax evasion in other countries.¹⁰⁶

The OECD recognizes that the more open competitive environment of the last decade has had many positive effects on tax systems. The more open environment discourages discrimination against non-residents and encourages countries to provide a fiscal environment that is conducive to cross-border activities. It also encourages innovation as countries learn from the mistakes and successes of others and adapt best practices. Concrete results can be seen from the base-broadening, rate-reducing measures that have characterized the tax reforms of member countries over the last fifteen (15) years. These reforms have provided greater neutrality within tax systems.

The OECD's Forum on Harmful Tax Practices is proceeding on three fronts to counteract harmful tax schemes.

One front involves member countries. The Forum has drawn up a list of potentially harmful preferential tax regimes, as depicted below (Table 3). The OECD countries that endorsed the Report agree first to a roll-back of the identified regimes within five (5) years and second to a standstill, *i.e.*, not adopting new measures or extending the scope of existing ones constitutive of harmful tax practices.¹⁰⁷

TABLE 3: PREFERENTIAL TAX REGIMES IDENTIFIED AS POTENTIALLY HARMFUL.¹⁰⁸

COUNTRY	REGIMES
<i>Insurance</i>	
Australia	Offshore Banking Units

¹⁰⁶ The OECD Report contains 19 Recommendations that deal with harmful tax schemes in OECD member countries and their dependencies and in non-member economies. In jurisdictions with a substantial domestic economy, the criteria consider whether any preferential regimes are ring-fenced from that economy. The scope of the work is limited to geographically mobile financial and other service activities. It is being taken forward by the OECD's Forum on Harmful Tax Practices, a body composed of representatives from all 29 OECD member countries, under the supervision of the main tax committee, the Committee on Fiscal Affairs. Horner, *supra* note 47.

¹⁰⁷ Owens, *supra* note 103.

¹⁰⁸ http://www.oecd.org/daf/fa/harm_tax/Report_En.pdf, *supra* note 19, at *12-14.

Belgium	Coordination Centers
Finland	Åland Captive Insurance Regime
Italy	Trieste Financial Services and Insurance Center *
Ireland	International Financial Services Center
Portugal	Madeira International Business Center
Luxembourg	Provisions for Fluctuations in Reinsurance Companies
Sweden	Foreign Non-life Insurance Companies

Financing and Leasing

Belgium	Coordination Centers
Hungary	Venture Capital Companies
Hungary	Preferential Regime for Companies Operating Abroad
Iceland	International Trading Companies
Ireland	International Financial Services Center
	Shannon Airport Zone
Italy	Trieste Financial Services and Insurance Center *
Luxembourg	Finance Branch
Netherlands	Risk Reserves for International Group Financing
	Intra-group Finance Activities
	Finance Branch

Spain	Basque Country and Navarra Coordination Centers
Switzerland	Administrative Companies
<hr/>	
<i>Fund Managers</i> **	
Greece	Mutual Funds/Portfolio Investment Companies [Taxation of Fund Managers]
Ireland	International Financial Services Center [Taxation of Fund Managers]
Luxembourg	Management Companies [Taxation of management companies that manage only one mutual fund (1929 holdings)]
Portugal	Madeira International Business Center [Taxation of Fund Managers]
<hr/>	
<i>Banking</i>	
Australia	Offshore Banking Units
Canada	International Banking Centers
Ireland	International Financial Services Center
Italy	Trieste Financial Services and Insurance Center *
Korea	Offshore Activities of Foreign Exchange Banks
Portugal	External Branches in the Madeira International Business Center
Turkey	Istanbul Offshore Banking Regime
<hr/>	
<i>Headquarters Regimes</i>	
Belgium	Coordination Centers

France	Headquarters Centers
Germany	Monitoring and Coordinating Offices
Greece	Offices of Foreign Companies
Netherlands	Cost-plus Ruling
Portugal	Madeira International Business Center
Spain	Basque Country and Navarra Coordination Centers
Switzerland	Administrative Companies
	Service Companies

*Distribution Center
Regimes*

Belgium	Distribution Centers
France	Logistics Centers
Netherlands	Cost-plus/Resale Minus Ruling
Turkey	Turkish Free Zones

*Service Center
Regimes*

Belgium	Service Centers
Netherlands	Cost-plus Ruling

*Shipping ****

Canada	International Shipping
Germany	International Shipping

Greece	Shipping Offices
	Shipping Regime
Italy	International Shipping
Netherlands	International Shipping
Norway	International Shipping
Portugal	International Shipping Register of Madeira
<hr/>	
<i>Miscellaneous Activities</i>	
Belgium	Ruling on Informal Capital
	Ruling on Foreign Sales Corporation Activities
Canada	Non-resident Owned Investment Corporations
Netherlands	Ruling on Informal Capital
	Ruling on Foreign Sales Corporation Activities
United States	Foreign Sales Corporations ****
<hr/>	

* non-operational

** The taxation of fund managers is complex, given the various legal forms that can be used to structure fund management advice. These issues will be studied further by the OECD in connection with the development of the application notes in order to ensure that all similar regimes are treated the same.

*** The analysis of shipping is complex given the particularities of the activity.

**** As is all other regimes, the foreign sales corporation regime is only within the scope of the Report to the extent that it applies to mobile financial and other service activities. It should be noted that the treatment of the foreign sales corporation regime or any other regime for purposes of the Report has no bearing on its classification or treatment in connection with trade disciplines.

A second front involves jurisdictions outside the OECD area that do not have incentives to cooperate in the fight against tax poaching. The Report refers to these jurisdictions as tax havens. They have little or nothing to gain from the demise of tax poaching.

On June 26, 2000,¹⁰⁹ the Forum has prepared the list of jurisdictions that meet the criteria of being tax havens (Table 4). Jurisdictions on this list can be subject to coordinated counteracting measures, as summarized below (Table 5), by member countries and other governments that choose to participate. The process of reviewing jurisdictions for possible inclusion has resulted in the possibility of an extended dialogue with jurisdictions that are interested in a cooperative dialogue and in making a certain level of commitment to the work. Cooperative jurisdictions can thus avoid the immediate consequences of being listed and are assured of not suffering competitive disadvantage *vis-à-vis* the uncooperative ones and of lessening the damage caused by harmful tax practices.

TABLE 4: TAX HAVENS¹¹⁰

Andorra	The Principality of Liechtenstein
Anguilla – Overseas Territory of the United Kingdom	The Republic of the Maldives
Antigua and Barbuda	The Republic of the Marshall Islands
Aruba – Kingdom of the Netherlands ♣	The Principality of Monaco
Commonwealth of the Bahamas	Montserrat – Overseas Territory of the United Kingdom

¹⁰⁹ Owens, *supra* note 103.

¹¹⁰ http://www.oecd.org/daf/fa/harm_tax/Report_En.pdf, *supra* note 19, at *17.

Bahrain	The Republic of Nauru
Barbados	Netherlands Antilles – Kingdom of the Netherlands ♣
Belize	Niue – New Zealand ♣♣
British Virgin Islands – Overseas Territory of the United Kingdom	Panama
Cook Islands – New Zealand ♣♣	Samoa
The Commonwealth of Dominica	The Republic of the Seychelles
Gibraltar – Overseas Territory of the United Kingdom	St Lucia
Grenada	The Federation of St. Christopher & Nevis
Guernsey/Sark/Alderney – Dependency of the British Crown	St. Vincent and the Grenadines
Isle of Man – Dependency of the British Crown	Tonga
Jersey – Dependency of the British Crown	Turks & Caicos – Overseas Territory of the United Kingdom
Liberia	US Virgin Islands – External Territory of the United States
	The Republic of Vanuatu

♣ The Netherlands, the Netherlands Antilles, and Aruba are the three countries of the Kingdom of the Netherlands.

♣♣ A fully self-governing country in free association with New Zealand.

These jurisdictions meet the tax haven criteria of the 1998 Report. Evaluations have been presented to the Committee in January 2000, confirmed in

May, and endorsed by the Council in June. The list reflects the technical conclusions only and is to be used as the basis for possible coordinated defensive measures. A further list will be developed in the next twelve (12) months for this purpose.

TABLE 5: CO-ORDINATED COUNTERACTING MEASURES.¹¹¹

- Adoption/application of new domestic defensive measures and rules to curb harmful tax practices for countries that do not have controlled foreign corporations (CFCs) or equivalent CFCs
- Comprehensive information reporting rules for transactions involving uncooperative tax havens or taking advantage of harmful tax practices
- Disallowance/denial of deductions, exemptions, credits, cost recoveries, or other allowances for payments made in transactions with uncooperative tax havens or involving jurisdictions with harmful tax practices
- Enhancement of audit and enforcement activities
- Imposition of withholding taxes on certain payments to residents of uncooperative tax havens
- Imposition of transactional charges or levies on certain transactions involving uncooperative tax havens
- Non-tax measures
- Termination of/prohibition on tax treaties and conventions with tax havens

The Forum's approach has been influenced by extensive dialogue with jurisdictions under review for the past twelve (12) months. All have been invited to in-person consultations with the Forum. A contact member country has also been assigned to each jurisdiction; significant bilateral contacts have been undertaken. The dialogues have been very productive and, in the course of them, many have expressed interest in a more extended dialogue and in the prospect of

¹¹¹ http://www.oecd.org/daf/fa/harm_tax/Report_En.pdf, *supra* note 19, at *25.

taking meaningful steps towards change. As a result, the economic impact of the transition will be mitigated.

The third front involves non-member economies that may also be affected by harmful tax practices. The OECD is engaged in a dialogue with such economies to encourage them to associate themselves with the principles and recommendations of the OECD Report.

The OECD fight against tax poaching is also supported and facilitated by efforts underway by other groupings of countries acting towards the same goal. The G7/G8¹¹² heads of state have specifically endorsed the OECD work and called for an intensification of dialogue between OECD and tax havens. The Summits of this exclusive and powerful club have consistently dealt with macroeconomic management, international trade, East-West economic relations, energy, and terrorism. From this initial foundation, the agenda has considerably broadened to include microeconomic issues, such as employment and the information highway, transnational issues such as the environment, crime, and drugs, and a host of political security issues ranging from human rights through regional security to arms control.¹¹³ Also, the European Union (EU) has adopted a Code of Conduct, binding on its members, that seeks to eliminate harmful tax practices.¹¹⁴

¹¹² Since 1975, the heads of state or government of the major industrial democracies have been meeting annually to deal with major economic and political issues facing their domestic societies and the international community as a whole. The six countries at the first Summit, held at Rambouillet, France in November 1975, were France, the United States, Britain, Germany, Japan and Italy. They were joined by Canada at the San Juan, Puerto Rico Summit of 1976, and by the European Community at the London Summit of 1977. Since then, membership in the G7 has been fixed, although fifteen (15) developing countries' leaders met with the G7 leaders on the eve of the 1989 Paris Summit, and the USSR and then Russia have had a post-Summit dialogue with the G7 since 1991. Starting with the 1994 Naples Summit, the G7 and Russia have met as the Political 8 (P8), following each G7 Summit. The Denver Summit of the Eight was a milestone, marking full Russian participation in all but the financial and certain economic discussions; and the 1998 Birmingham Summit saw full Russian participation, giving birth to the G8, although the G7 continues to function alongside the formal summits. *From G7 to G8*, at http://www.g7.utoronto.ca/g7/what_is_g7.html (last visited Feb 19, 2001 1:48:38 PM).

¹¹³ *Id.*

¹¹⁴ The EU and OECD projects are mutually reinforcing, although they differ in some important respects. The Code of Conduct is not limited in scope to financial and service activities and does not address tax haven issues, other than dependencies of EU members. The Code of Conduct also has a number of features that could lead the EU to exclude harmful tax practices that are covered by the OECD Report. More particularly, the OECD places great emphasis on a jurisdiction's effective exchange of information practices; the Code does not. The

It is worthy to note that even the Asia Pacific Economic Cooperation (APEC) declares to work with the private sector and governments in the region to develop principles governing e-commerce and a template to assist economies in developing e-commerce within their own economy. APEC leaders are recommended to seek agreement in the WTO not to impose any new customs duties on electronic transactions over the Internet. Governments and the business sector are urged to agree to review existing domestic legislation to make the same technology-neutral.¹¹⁵

III. COMPARISON WITH FOREIGN COUNTRIES' TAX RULES

There are a number of legal and technical obstacles that prevent the full exploitation of e-commerce despite the phenomenal growth in the Internet for commercial purposes. The virtual environment of e-markets, for instance, makes it difficult to determine who the contractants are, where an operator is established, and whether that operator is complying with all relevant legal obligations and regulatory regimes. This creates legal and regulatory uncertainties about which jurisdiction will be competent and about the applicable law in disputed cases, thus making it more difficult for e-commerce companies to adapt their sites to conform to national rules.¹¹⁶

On the technical aspect, consumers have already expressed concerns over privacy, consumer protection, security of credit card purchases, order fulfillment, and delivery.¹¹⁷ The absence of commercial codes and legal recognition covering the acceptance of electronic signatures and documents, contract enforcement,

latter applies only to preferential regimes, *i.e.*, regimes that provide a lower rate than that generally applicable in the country. Hence, a no tax jurisdiction cannot violate the Code, even if the jurisdiction refuses an effective exchange of information. This practice is considered harmful under the Report.

The EU has not officially reported out substantive conclusions from the Code of Conduct Group as is anticipated for the December 1999 Helsinki summit. However, substantial progress has been made in the analysis of preferential regimes within the EU, and the results will be valuable as the work moves forward. Horner, *supra* note 47.

¹¹⁵ <http://www.apecsec.org.sg/> (last visited February 23, 2001 7:35:29 PM).

¹¹⁶ For example, regulations on advertising outlaw the use of English in France, advertising to children in Denmark, and comparative advertising in Germany, yet the content on the Internet is essentially borderless. It is not yet clear how countries will apply such rules to the Internet. Coppel, *supra* note 2, at *13.

¹¹⁷ *Id.*

and the need for greater certainty *vis-à-vis* liability for damages that may arise as a result of electronic transactions will limit the take-up of e-commerce in the B2B sphere.¹¹⁸ These issues are particularly magnified in cross-border trade.

There are also a number of concerns regarding the governance of the Internet itself. The increase in e-commerce will not only expand the number of Internet addresses required but also accelerate the need for further reform of the Domain Name System (DNS).¹¹⁹ Such addresses should be easy to acquire, reliable with mechanisms for dispute resolution, structured, and expansive. Reform of the DNS and the Internet Protocol (IP) Numbering System¹²⁰ is likewise important for exercising regulatory oversight, law enforcement, consumer protection, tax compliance, protection of intellectual property rights, and protection of minors.

As the expiration draws near, legislation in the United States which extended the moratorium from the original three years as provided for in the Internet Tax Freedom Act (ITFA)¹²¹ to five years was introduced in February 6, 2001.¹²² A staff discussion draft of the so-called "Internet Non-Discrimination and Sales Tax Simplification Act" proposes that the moratorium on Internet access taxes and multiple and discriminatory taxes be extended until December 31, 2006.

The provisions of the extended moratorium are essentially identical to the one established under ITFA in 1998. However, the bill includes language eliminating the original act's grandfather clause which preserved existing taxes on Internet access generally imposed and actually enforced prior to October 1, 1998. It also addresses state sales tax simplification, which is being attempted in the

¹¹⁸ In the United States, the e-sign bill that will recognize nationwide digital signatures as legally binding is currently before the Congress. In November 1999, the European Union adopted a directive recognizing e-signatures. *Id.*

¹¹⁹ The DNS is a scheme for translating numeric Internet addresses into user-friendly strings of word segments denoting user names and location. The Internet naming scheme consists of a hierarchical sequence of names, from the most specific to the most general, in a left to right order, separated by dots. <http://www.pmel.org/EC-Glossary.htm>, *supra* note 23.

¹²⁰ The DNS and IP Numbering System are the signposts on the information highways and enable the networks to function. Coppel, *supra* note 2, at *14.

¹²¹ The aim of the ITFA is to render neutral the tax treatment of economic activity, electronic or otherwise. It precludes state and local taxes that discriminate against or single out the Internet. "If I'm So Empowered, Why Do I Need You?": *Defining Government's Role in Internet Electronic Commerce*, *supra* note 44.

¹²² Doug Sheppard, Cox, Wyden to Introduce Bill to Extend Internet Tax Moratorium, *Source Says*, at http://www.tax.org/ecommerce/ecom_feature2f.htm (last visited Feb 8, 2001 3:20:53 AM).

state-led Streamlined Sales Tax Project, by providing for clear standards that will determine the nexus of business activity and by establishing a fast-track procedure for congressional authorization in order for states to require remote sellers to collect sales taxes.¹²³

Under current state laws of the United States, companies are not required to collect sales taxes from consumers making out-of-state on-line or mail-order purchases. Payment responsibility falls solely on the customer and enforcement is difficult, thus creating a *de facto* tax-free environment. Moreover, there are substantial tax penalties for integrating brick-and-mortar and on-line operations.¹²⁴ Companies avoid these penalties by establishing separate subsidiary on-line entities. To satisfy legal requirements, the two operations must be truly separate. An on-line purchase cannot be picked up at a local store. If a company wants to integrate both off- and on-line operations, the corresponding sales taxes will be charged, regardless of where the purchase is made.

Sales taxes are imposed on sales transactions that occur within the boundaries of the taxing jurisdiction. These taxes are collected by the seller from the buyer at the time of sale and then remitted to the governments imposing them.¹²⁵ The central issue of sales taxes is critical. In the current tax-free e-commerce world, consumers do not pay sales taxes. Charging the same increases the price of a good or service on-line.¹²⁶

The power of taxation belongs exclusively to the legislative branch of the government, but it may be delegated to municipal corporations, which are merely instrumentalities of the State for the better administration of the government in matters of local concern.¹²⁷ When such a corporation is created, the power of

¹²³ Two state organizations, the National Governors' Association and the National Conference of State Legislatures (NCSL), have already gone on record opposing any extension of the moratorium, arguing that it raises issues concerning the bundling of tax-free Internet access with taxable phone and cable services – which can significantly erode state and local tax bases. *Ibid.*

¹²⁴ Austan D. Goolsbee, *The Impact of Sales Tax on E-Commerce: The Cost of Integrating Off- and On-Line Operations May Be More than Companies Bargained for*, at <http://gsbwww.uchicago.edu/news/capideas/sum00/goolsbee.html> (last visited Feb 11, 2001 2:20:42 AM).

¹²⁵ "If I'm So Empowered, Why Do I Need You?": *Defining Government's Role in Internet Electronic Commerce*, *supra* note 44.

¹²⁶ If sales taxes were charged, Internet retail sales could decrease by up to twenty-four *per centum* (24%). Therefore, existing brick-and-mortar businesses looking to expand their markets need to think twice before setting up shop on-line. Goolsbee, *supra* note 124.

¹²⁷ *United States v. New Orleans*, 98 U.S. 226 (1879).

taxation is vested in it as an essential attribute, for all the purposes of its existence, unless its exercise is in express terms prohibited. For the accomplishment of these purposes, its authorities, however limited the corporation, must have the power to raise money and control its expenditures. A municipal tax ordinance empowers it to impose taxes.¹²⁸ A municipality or local government unit (LGU) without this power would be a body without life, incapable of acting and serving no useful purpose. The problem today is that if states and local governments were to immediately begin taxing on-line sales, cross-border definitional and enforcement policy differences would definitely impose enormous compliance costs on e-commerce businesses as they struggle to understand these requirements and sort through state-to-state conflicts. The tax rules would appear neutral on their face – telling both Internet and over-the-counter or off-line sellers to collect taxes on the sale of all tangible goods – but the rules would actually cause severe disadvantage to digital stores, because their costs of compliance would be punishing. Neutrality does not merely mean that buyers be required to pay the same tax rate at all stores; it also entails comparable compliance costs for these stores.¹²⁹ While an e-commerce sale of tangible goods entails their shipment to the buyer, thereby establishing a basis for ascertaining a *situs* for sales tax purposes, there is no such “*bright line test*” for electronic delivery. The arguments put forth here do not justify maintaining the status quo, but they do support an effort to create a sales tax system that is neutral in the overall burden that it places on all buyers and sellers.

A workable system for intangibles will require sellers to collect the buyer’s billing address, for which the seller has no business need if the product is digitized. Even if the seller obtains the buyer’s billing address – which can be rebuttably presumed to be the ship-to address – a buyer in a jurisdiction that taxes e-delivery¹³⁰ of software, books, or music can in fact just buy it as a gift for someone in another jurisdiction that does not levy such tax. Under a proposal that will tax the sale of tangible goods, the seller will collect the sales taxes for the jurisdiction to which such goods are shipped. Hence, the buyer’s taxing jurisdiction will not capture the transaction when the sale is structured as a gift. After the seller delivers the goods, the recipient would forward it to the buyer. Even if this

¹²⁸ *Reyes v. CA*, G.R. No. 118233, December 10, 1999.

¹²⁹ “*If I’m So Empowered, Why Do I Need You?*”: *Defining Government’s Role in Internet Electronic Commerce*, *supra* note 44.

¹³⁰ Taxing digitized goods and services that are delivered electronically appears nearly impossible, because the source and destination are difficult to identify and easy to manipulate. *Federal E-Commerce Commission Grapples with Tax Issues*, at <http://www.caltax.org/e-alerts/e-Alert.ecommerce.12-17-99.htm>. (last visited Feb 11, 2001 2:20:42 AM).

circumvention is outlawed, it is doubtful that any affordable and practical system can be created to catch the tax evaders. While current bandwidth limitations discourage this triangular delivery system, that problem will not last long. The advent of the broadband revolution will allow mining the illimitable Internet reservoir at a higher throughput per unit of time measured in kilobits, megabits, or gigabits per second.¹³¹ It will allow users access to a new range of multimedia possibilities and net-based entrepreneurial opportunities that will put to shame the monitoring rules under conventional sales tax regimes.¹³²

If those constructing a new sales tax system truly want to embrace the neutrality principle, they must not discriminate for or against certain channels of commerce – whether over the counter at a local store, over the Internet, over the telephone, on the television, in one's mobile phone, mailbox, or email. A rational and neutral solution can be crafted, but two policy milestones to be reached:¹³³

First, a consensus must be achieved that e-commerce should not be taxed in and of itself. There should neither be special Internet access taxes nor creative attempts to cram new on-line services into old tax definitions. In other words, visiting a mall should not be taxed, even if the purchases made there are. Otherwise, governments will be acting simply as toll collectors reacting to the sight of an opportunity to promiscuously collect money. A toll is justifiable when it supports the efficient maintenance of a road or bridge; in the United States, however, after general tax revenues have fully paid for the initial development of the Internet by its federal government, any discriminatory state or local taxes on the Internet will have no justification.¹³⁴

¹³¹ In 2001, Europe, the U.S., and the rest of Asia will get services based on the General Packet Radio Service (GPRS) that made Japan's mobile phone operator DoCoMo's i-mode service successful – leading to the introduction of always-on Internet, flat-rate pricing, and a new standard for Wireless Access Protocol (WAP), making the phones easier to use. However, there will still be problems on network capacity, technology glitches, consumers balking at the price tag for high-speed connections, and reticence from carriers worried about cannibalizing existing services. Schenker, *supra* note 38, at 54-55.

¹³² Some of the services under this technology are streaming video, full-motion high-resolution video conferencing, voice over IP (VoIP), and applications service provisioning. MAELYN ANGULO, BROADBAND: THE FUTURE OF THE INTERNET. (on file with authors).

¹³³ "If I'm So Empowered, Why Do I Need You?": Defining Government's Role in Internet Electronic Commerce, *supra* note 44.

¹³⁴ *Id.*

Second, an international approach to sales and use tax collection must be devised for all cross-border sales – including “mail-order” sales. It must be easily understood by buyers and sellers, ensure that sales are taxed only once, make clear what goods are taxed and at what tax rate, and be designed from the start to be reliable and low-cost for all taxpayers. Perhaps, vendor compensation may encourage voluntary compliance.

There are many doubtful issues regarding the imposition of taxes on Internet transactions. The Philippine E-Commerce Act did not address the tax *situs* concern. Certainly it did not resolve any question regarding the scope and breadth of the tax jurisdiction of national and local tax authorities; neither did the IRR.¹³⁵ The Internet is structured in such a way that a website may be locally developed but actually hosted in another jurisdiction.¹³⁶ Who and what will be taxed may be difficult to determine with precision, given the rapid pace of technological advances. Yet the need for taxation is imperative.

The principle of neutrality in taxation must also be upheld in any move to tax these transactions.¹³⁷ It would only be fair to tax local, not interstate, electronic transactions by uniformly applying conventional tax rules; otherwise, the industries, ventures, and entities availing of the technology will not be globally competitive.¹³⁸ It is thus important to look at the types of taxes that may be relevant in the various Internet transactions.

Possibly the single biggest source of internal revenue, income taxes are imposed on almost all types of business transactions, including those executed over the Internet. While resident citizens and domestic corporations are taxed on worldwide income or all income derived from sources within and without the Philippines,¹³⁹ nonresident citizens, overseas contract workers (OCWs), alien individuals (whether resident or not), and foreign corporations (whether engaged or not in trade or business in the Philippines) are taxed only on Philippine-sourced income or all income derived from sources within.¹⁴⁰ In Internet transactions, it

¹³⁵ Written comment from Atty. Noel Guivani Ramiscal, legal consultant for electronic commerce, intellectual property rights, and indigenous rights (February 19, 2001) (on file with the authors).

¹³⁶ Interview with Juan Chua, *supra* note 60.

¹³⁷ Written comment of Atty. Noel Guivani Ramiscal, *supra* note 135.

¹³⁸ Interview with Juan Chua, *supra* note 60.

¹³⁹ TAX CODE, sec. 23 (A) and (E).

¹⁴⁰ REP. ACT 8424, sec. 23 (B), (C), (D), and (F). Where the taxpayer is a foreign national whose country of residence has entered into a tax treaty with the Philippines, other restrictions

becomes problematic where the source of income is determined, because the principle of the traditional physical business presence in terms of assets, personnel, or both becomes diluted. Foreign merchants can exploit the domestic market without even having to establish physical presence.¹⁴¹ The BIR must state categorically whether a website or server is a permanent establishment for establishing the nexus. It would do well to use the economic presence standard earlier referred to in order to avoid the resulting valuation and allocation difficulties. As likewise held by the Court,¹⁴² business implies continuity and progression of transactions, while activity may consist only of a single transaction. An activity may occur outside the place of business. Section 24 of the Tax Code does not require a foreign corporation to engage in business in the Philippines in subjecting its income to tax. It suffices that the activity creating the income is performed or done in the Philippines. What is controlling, therefore, is not the place of business but the place of activity that creates an income in order to establish the nexus. It is urged that the concept of permanent establishment be abandoned in favor of the principle of taxation in the source country. The old concept embodies the definition of a threshold of activity under which the company is taxed only in the country of residence: a threshold which could be abandoned in favor of a minimum turnover. The countries will however have to agree on the way to determine where income is originated and on the practical difficulties of taxing a person who has no physical business presence in the source country.¹⁴³

The Value-Added Tax (VAT) is another relevant tax. While it applies to almost all types of Internet transactions, the imposition on nonresident citizens, OCWs, alien individuals, and foreign corporations will definitely require a determination of where the transaction takes place. When, for example, actual service is provided online that involves the establishment of an ongoing

may apply, such as the attribution requirement of income to a permanent establishment found in article 5 of these treaties. Under this concept, the Philippine government can tax the business income or profits of a foreign enterprise if it maintains a permanent establishment in the Philippines, defined as a fixed place of business in which the business of the enterprise is wholly or partly carried on.

¹⁴¹ Cabreros, *E-Commerce: Its Implications on Tax Treaties*, 36 PHIL. REVENUE J. 3, 16 (2000).

¹⁴² Phil. Guaranty Co., Inc. v. Commissioner of Internal Revenue, G.R. No. L-22074, April 30, 1965.

¹⁴³ Doernberg, *supra* note 5, at 373

relationship between the foreign service provider¹⁴⁴ and a local customer in areas like professional service, consultancy work, banking, stock trading, Internet databases, and even gambling, a tax loss is expected, because this B2B or B2C sphere can and does occur directly and privately between the parties without the knowledge of tax authorities, there being no need to establish physical presence by the foreign service provider. Under the Independent Personal Service and Dependent Personal Services provisions,¹⁴⁵ the *length of stay test*, normally an aggregate of 183 days, to determine taxability of services rendered in the source country may no longer hold. Necessarily, how the provisions on gross income affect the rendition of service in a Contracting State or host country will be of vital concern to both tax authorities and taxpayers.¹⁴⁶

Royalties as typically defined in article 12 of tax treaties are payments of any kind received as a consideration for the use of, or the right to use, any copyright, patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial, or scientific experience, and include payments of any kind in respect of motion picture films and works on films or videotapes for use in connection with television. These shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, local authority, or resident of that State. Where, however, the person paying the royalties, whether resident or not of a Contracting State, has in a Contracting State a permanent establishment or fixed base in connection with which the obligation to pay the royalties was incurred, and those royalties are borne by that permanent establishment or fixed base, then such royalties shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated. It is not clear under the E-Commerce Act how this definition typically found in tax treaties will apply to digitized goods and services that are sold and not merely licensed. There seems to be a tremendous impact on these royalties being treated as gross income,¹⁴⁷ when licensing is involved. The BIR should be definitive first in determining whether these are goods or services; second, in treating these as income from sale of goods or from royalties; and third, in clarifying the definition found in concluded or pending tax treaties.

¹⁴⁴ A foreign service provider is one whose principal place of business is outside the Philippines or is created or organized under foreign law, and complies with Section 5 of REPUBLIC ACT 8792.

¹⁴⁵ These are typically Articles 14 and 15 of tax treaties.

¹⁴⁶ REP. ACT 8424, sec. 42 (A) (3) and (C) (3).

¹⁴⁷ REP. ACT 8424, sec. 42 (A) (4) and (C) (4).

In matters of sale of personal property, the tax law states that, generally, the income is treated as derived from the country in which said property is sold. Under the Income Tax Regulations, the country in which the property is sold means the place where it is marketed,¹⁴⁸ but where this is may be contentious, applying the civil law provisions depending on whether the personal property sold is tangible or intangible.¹⁴⁹

Percentage taxes, though initially an issue, are not applicable even if service providers are considered public utilities. The law imposes percentage taxes on international carriers.¹⁵⁰ Though it may be considered that the Internet may in fact be a way of carrying goods or services in digitized or soft-copy form, and may be sent from one jurisdiction to another, our law is clear in that it only applies to international air and shipping carriers doing business in the Philippines. There are no percentage taxes currently imposed on electronic money transfers that may be likened to the flow of information and images through the Internet. Even if service providers are assumed to be public utilities, still the same are not liable for percentage taxes imposed in respect to all franchises on radio and/or television broadcasting companies.¹⁵¹ The enumeration under the law is exclusive and read in favor of the taxpayers.

At the provincial level, percentage taxes on franchises are recognized.¹⁵² Such an application is further strengthened by the fact that notwithstanding any exemption granted by any law, the goods that come from other countries may ultimately be taxed as though imported from another jurisdiction. This will then still fall under the broad taxation for VAT.

Documentary stamp taxes (DSTs) also affect Internet transactions. The execution or issuance of a taxable document is not always a prerequisite for DST imposition, unlike in other jurisdictions. What is relevant is when the obligation or right arising from the taxable document or transaction arises from Philippine sources or the property involved is located in the Philippines. For example, DSTs are payable on the original issuance or subsequent transfer of shares of stock, regardless of where this has taken place. As technology develops, physical certificates or instruments may no longer represent these shares and transfers, and reissuances may in fact be accomplished by mere computer entries. Since the

¹⁴⁸ This therefore refers to the country where title to property passes, under sec. 159.

¹⁴⁹ CIVIL CODE, arts. 416-417.

¹⁵⁰ REP. ACT 8424, sec. 118.

¹⁵¹ REP. ACT 8424, sec. 119.

¹⁵² LOCAL GOVT. CODE, art. 137.

existing law requires the filing of tax returns for these taxes, usually accompanied by written deeds of assignment, the same technology may be used if taxation is to keep up with the mode and pace by which electronic issuances and transfers are made.¹⁵³

The BIR is not alone; the Bureau of Customs (BOC) is also initiating measures in the way tariff laws are implemented under this phenomenal technology. It has pursued an ambitious computerization program about five years ago, as a result of which importers are now able to transact with the agency using a remote computer in filing import declarations through an EDI or Direct Trader Input (DTI) system. They can thereafter avail of the new and faster import clearance procedures referred to as the Super Green Lane.¹⁵⁴

The GTEBnet of the Garment and Textile Export Board (GTEB) is also one of the first government e-commerce applications. With the help of an electronic network, GTEB is more effectively discharging its functions of administering quota allocation for exporters of garments and textiles, processing export documents needed by garment and textile exporters, and serving as a regulatory board.¹⁵⁵

The same is true with the Land Registration Authority (LRA) and the Land Transportation Office (LTO), currently and simultaneously undergoing comprehensive computerization development and acquisition programs.¹⁵⁶ Even the Social Security System (SSS) has launched the SSSNet to electronically connect with its partners and customers in the e-filing by employers of quarterly collection reports,¹⁵⁷ and the Bureau of Treasury under the Department of Finance has commenced the Small Investor Program (SIP) to handle the sales of government financial instruments to small and medium sized investors.¹⁵⁸

¹⁵³ Reyes, *Issues on E-Commerce Taxation in the Philippines*, 9 (Aug 2000) (unpublished manuscript, on file with authors)

¹⁵⁴ Tan-Torres, *The (Near) Future of Cybertaxation in the Philippines*, 36 PHIL. REVENUE J. 3, 13 (2000).

¹⁵⁵ E. C. Lallana, *supra* note 50, at 11.

¹⁵⁶ Tan-Torres, *supra* note 154.

¹⁵⁷ E. C. Lallana, *supra* note 50, at 11-12.

¹⁵⁸ *Id.*

Not to be outdone are some LGUs¹⁵⁹ that have developed computerized tax systems to improve revenue collections and taxpayer service in C2G and to disseminate information in G2C. They in fact have the power to levy taxes, fees, or charges, not otherwise specifically enumerated in the Local Government Code of 1991 or taxed under the Tax Code, as amended, or other applicable laws.¹⁶⁰ This power is only limited by the following requirements, namely: (1) these should not be unjust, excessive, oppressive, confiscatory, or contrary to declared national policy; and (2) that prior public hearings are held where the views of the people are heard.¹⁶¹ Over businesses conducted within their jurisdictions, for instance, municipalities and cities have broad taxing authority in imposing business taxes at the rates of two *per centum* (2%) and two and a half *per centum* (2.5%), respectively, of the gross sales or receipts of the preceding calendar year.¹⁶² The *situs* is again not easily identifiable in Internet transactions conducted not only by foreign online merchants but also by local ones maintaining offices in one municipality or city and conducting e-commerce transactions in another. The LGUs concerned should, through their respective leagues, address this concern in the same manner that the national government, through the BIR, does.

New taxes like bit or byte taxes¹⁶³ may only result in impeding or stunting the growth of e-commerce.¹⁶⁴ Pioneering industries, such as ventures into e-commerce, should be given tax breaks and incentives to encourage investors to go into this new field.¹⁶⁵ The same privileges should apply to online sellers and promoters of goods or services that those in the real world already excel in. A bit or byte tax, in fact, is currently being opposed. It is perceived in France, for instance, to be discriminatory for users of the net. Moreover, it does not take into consideration the value added to the information in the bit. The British view it as having no relation to the value of information or services being provided. According to them, the present VAT system in the EU can be adapted to meet the needs of e-commerce. Colombian authorities believe it is not concordant with

¹⁵⁹ The City of Muntinlupa has taken an early initiative in this area. Tan-Torres, *supra* note 154.

¹⁶⁰ LOCAL GOVT CODE sec. 186.

¹⁶¹ THE REVENUE REP., March 2000, at 1.

¹⁶² LOCAL GOVT CODE, sec. 143 (h), 144, and 151.

¹⁶³ A bit or byte tax is a new tax that is imposed on data, not on the value of transactions, and other mechanisms for extracting revenue from the net. <http://www.caslon.com.au/taxationguide.htm> (last visited Feb 18, 2001 5:55:32PM).

¹⁶⁴ While taxation of e-commerce may be desirable purely from a revenue standpoint, one also has to consider its impact in dampening or impeding economic growth. Reyes, *supra* note 153, at 3.

¹⁶⁵ Email of Vicky Lim-Tan, *supra* note 43.

the neutrality principle in taxation. For the Italians, however, this tax, if imposed on information and messages being electronically transmitted and the tax on PCs, is to be recommended.¹⁶⁶

Taxing Internet transactions increases transaction costs and makes it more expensive to do banking transactions from places other than the branch locations. This directly opposes the thrust of Internet banking that offers simple access, low transaction costs, anonymity, and immediacy in transferability of funds.¹⁶⁷ As a result, there arises a clear deterrence to economic progress – a restraint on the individual to use the Internet to save time that can be put to better use for other endeavors and a disincentive to financial institutions that seek to forge strongly into e-commerce since the initial outlay in terms of capital expenditure will not justify the low volume of transactions over the net.¹⁶⁸ Not unless there is a deep resource base and a longer-term vision by the bigger banks, going into e-commerce simply makes no sense to profit-driven banks.¹⁶⁹ Besides, only a small percentage of the populace is ICT-inclined; the market is not large enough as yet. Banks are reluctant to commit to new technology and new payment types before consumers are prepared to embrace them.¹⁷⁰ The e-commerce revenue figure, as it stands today, is very miniscule – most of the local online purchases are made by nonresident citizens for delivery to resident citizens,¹⁷¹ much like the PadalaRegalo.com of Cyberspace, Inc.¹⁷²

The logistics should also be considered. The BIR may not be competent enough to monitor these transactions. What sort of software, standards, and user protocols must be used or established in order to exact these taxes?¹⁷³ The present tax system does not have the resources or architecture to keep track of rightful

¹⁶⁶ Doernberg, *supra* note 5, at 379.

¹⁶⁷ E. C. Lallana, *supra* note 50, at 45.

¹⁶⁸ Email of Vicky Lim-Tan, *supra* note 43.

¹⁶⁹ Financial institutions that implement custom, branded web portals can benefit from more effective communications with customers, reduced risk of competitors accessing their customer base, enhanced revenue opportunities from cross-selling and personalizing financial services, and Internet access and content that can be managed, tailored, packaged, and priced according to different customer segments. Lopez, *HP's Internet Banking Solution Powers Metrobank's Offensive in E-Commerce*, MANILA BULLETIN, February 18, 2001, at B-8.

¹⁷⁰ Dan Amdur, *European Banks Play Their (Smart) Cards*, BYTE, April 1997, at 47.

¹⁷¹ Interview with Juan Chua, *supra* note 60.

¹⁷² This URL is an online shopping mall built and operated by an ISP to allow overseas Filipinos to patronize local goods and services that are delivered within a shorter than traditional period to designated local recipients and with payment effected through credit cards. Lopez, *supra* note 169, at B-8.

¹⁷³ Written comment of Atty. Noel Guivani Ramiscal, *supra* note 135.

taxes due and their collection. The legal and regulatory framework should be a solid starting point, supported by resource and budget allocation from the government to strengthen the automated system in the BIR.¹⁷⁴ There must be a long-term plan and short-term strategies to effectively carry out its mandate under the E-commerce law, independent of the political process in appointing heads with every change in administration.

Traditional paper audit trails¹⁷⁵ will disappear, thus making it more difficult for tax authorities to trace the various Internet transactions because of the lack of links between electronic entities and their physical counterpart.¹⁷⁶ In fact, with audit trails eliminated or distorted, the flow of transactions cannot be explicitly traced.¹⁷⁷ Tax authorities need to focus upon the controls employed by taxable entities. If these are adequate, the electronic system is likely to be reliable. But then, web users may also establish Internet addresses in almost any taxing jurisdiction, regardless of their residence or source of income-generating activities. Potentially harmful tax schemes in the form of tax havens and offshore banking facilities will thus increase, not to mention the relocation to export processing and ICT economic zones under Republic Act No. 5186, the Foreign Investments Act, and special laws. Besides, B2C will be more difficult to keep track than B2B.¹⁷⁸

For instance, consider the use of credit cards in an ordinary online purchase process. First, the consumer decides to make a purchase from a web merchant's store, based on transaction information provided by the merchant which may be considered at most as a mere offer in our jurisdiction and does not give rise to an obligation without absolute acceptance communicated to the merchant,¹⁷⁹ or a public offer in other jurisdictions and, therefore, already a source of obligation. Second, the consumer clicks on a pay button, prompting the input for the choice of credit card and other data. The transaction information is digitally signed by the consumer, encrypted, and sent to the merchant. Third, the merchant server signs, encrypts, and forwards the transaction information to a third party server. Credit card numbers are encrypted with the third party's public key, so merchants never have to handle them directly. Fourth, the third party

¹⁷⁴ Email of Vicky Lim-Tan, *supra* note 43.

¹⁷⁵ Records and documents are physical evidence of executed transactions and collectively represent the audit trail that is so critical to an auditor or examiner when tracing transactions through an accounting system. D. N. RICCHIUTE, *AUDITING CONCEPTS AND STANDARDS* 260 (2nd ed., 1991).

¹⁷⁶ E.C. Lallana, *supra* note 50, at 45.

¹⁷⁷ Ricchiute, *supra* note 175, at 294.

¹⁷⁸ Interview with Juan Chua, *supra* note 60.

¹⁷⁹ CIVIL CODE, art. 1319.

server decrypts and certifies the transaction data and forwards it through a private network to the merchant's bank for authorization. And fifth, the merchant's bank processes the charge automatically. It then returns an approval or denial to the third party server, which passes it on to the merchant. The merchant then passes it on to the consumer. The whole process, which may also be applied to a consumer's checking account, may take fewer than twenty (20) seconds. In this simple scenario, the BIR will already have to deal, *inter alia*, with the issues of the contract arising,¹⁸⁰ the *situs* of the transaction,¹⁸¹ the provider of the service,¹⁸² the encryption/decryption technology, and the collection, not to mention the exemptions allowed under tax treaties.¹⁸³

Disintermediation¹⁸⁴ will remove convenient taxing points¹⁸⁵ as we mark an exodus from normal channels of business to others that allow more direct

¹⁸⁰ It is important to note that Article 5 of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Electronic Commerce states that information shall not be denied legal effect, validity, or enforceability solely on the ground that it is in the form of a data message, after which provision Section 6 of the E-Commerce Act and Section 7 of its IRR have been patterned. <http://www.uncitral.org/english/texts/electcom/ml-ec.htm> (last visited Feb 23, 2001 7:58:08 PM).

¹⁸¹ In cyberspace, it may no longer be easy to identify the *situs* or the locale of the commercial transactions. I. J. UY, COMMENTS IN THE ELECTRONIC COMMERCE ACT: BUILDING THE NATIONAL ECONOMY ONLINE 23 (2000).

¹⁸² Under REPUBLIC ACT 7925, ISPs are deregulated value-added services that merely require registration with the National Telecommunications Commission (NTC), and not a congressional franchise. E. V. CABARIOS, REGULATION OF ISPs IN THE ELECTRONIC COMMERCE ACT: BUILDING THE NATIONAL ECONOMY ONLINE 53 (2000).

¹⁸³ As of June 2000, the Philippines has twenty-nine (29) tax treaties in force that promote cross-border investments and exchange of goods and services by avoiding double taxation and preventing fiscal evasion with respect to taxes on income. The others are still pending exchange of instruments of ratification/notification; pending ratification; pending signature; under negotiation; or under preliminary communication or proposed negotiation/renegotiation. Olivan, *BIR Negotiates Tax Treaty with Bahrain*, 36 PHIL. REVENUE J. 3, 6 (2000).

¹⁸⁴ Disintermediation is the move from normal channels to ones that allow more direct interaction between buyers and suppliers. <http://www.manufacturing.net/magazine/purchasing/depts/ecgloss.html> (last visited Feb 18, 2001 5:55:30PM).

Part of the cost savings associated with the Internet come from the reduction in the need for intermediaries in the business process. Distributors, sales representatives, and brokers may in many cases no longer be needed in some business activities, or replaced by other intermediaries such as web page designers, Internet security experts, and marketers of web pages. For example, downloadable software may eliminate the need for retail establishments; downloadable airline tickets, the need for ticket agents. As methods of encryption and other security measures become more sophisticated, businesses and their customers will more freely trust online ordering of goods and services and payment mechanisms. Doernberg, *supra* note 5, at 6-7.

interaction between buyers and sellers.¹⁸⁶ Consumption taxes become less viable sources of revenue and withholding taxes on certain transactions more cumbersome.¹⁸⁷

With these concerns come the implications on the security and privacy of individual consumers who have, at least, until now, relied on the anonymity fostered by the Internet.¹⁸⁸ Firewalls should be present such that privacy is not violated, *i.e.*, the BIR can keep tab of the length in minutes or seconds and the costs paid, but not the content of the e-transaction or message.¹⁸⁹

Setting up an international body to monitor and tax the various Internet transactions is almost impossible; the logistics involved would be too complicated. There are tens of millions of websites in the world today, not all are even involved in e-commerce, and these are increasing by hundreds of thousands per day.¹⁹⁰ Instead, a reasonable and consistent tax system that conforms to generally accepted Internet standards must be developed in each jurisdiction. It must neither be restrictive nor over-expansive. Since achieving this rational tax system will entail forging a consensus among various states that have long histories of taking divergent approaches to taxing commercial and non-commercial activities, reaching the goal will take some time. Implementing the same will be even longer, but with the end in view of reducing, if not eliminating, the digital divide.¹⁹¹

Information technology in the form of the Internet accelerates the consensus process in three ways. First, it facilitates the negotiation of treaty-based regimes, and makes it possible for new international legal machinery to operate effectively and more quickly. Second, it alters the balance of interests that shape the political dynamics that eventually determine the content of international law. Third, its global character puts stress on traditional state-based precepts of private

¹⁸⁵ E. C. Lallana, *supra* note 50, at 45.

¹⁸⁶ <http://www.manufacturing.net/magazine/purchasing/depts/ecgloss.html> (last visited Feb 18, 2001 5:55:30 PM).

¹⁸⁷ Voluntary assessment or withholding, although useful in certain cases, may prove inadequate for most types of e-commerce transactions. Reyes, *supra* note 153, at 3.

¹⁸⁸ Written comment of Atty. Noel Guivani Ramiscal, *supra* note 135.

¹⁸⁹ Email of Vicky Lim-Tan, *supra* note 43.

¹⁹⁰ Interview with Juan Chua, *supra* note 60.

¹⁹¹ Digital divide refers to the gap between individuals, households, businesses, and geographic areas at different socio-economic levels with regard to their opportunities to access ICTs and their use of the Internet. It reflects differences among and within countries, and raises a number of questions. http://www.oecd.org/subject/e_commerce/ (last visited Feb 18, 2001 5:55:32PM).

international law, increasing the pressure for public international law regimes to regulate Internet commerce and political activity directly or indirectly by providing frameworks for private ordering.¹⁹² Any international agreement should be self-executing so that the legislative implementation by state authorities will not be necessary.¹⁹³

It would do well for the BIR to seriously consider adopting the Seven Criteria to Judge Proposals to Tax the Internet, which has been developed within the OECD.¹⁹⁴ These criteria are:

1. The system should be *equitable*: taxpayers in similar situations that carry out similar transactions should be taxed in the same way;
2. The system should be *simple*: administrative costs for the tax authorities and compliance costs for taxpayers should be as minimal as possible;
3. The rules should provide *certainty* for the taxpayer so that the consequences of a transaction are known in advance: taxpayers should know what is to be taxed and when – and where the tax is to be accounted for;
4. Any system adopted should be *effective*: it should produce the right amount of tax at the right time and minimize the potential for tax evasion and avoidance;
5. *Economic distortions should be avoided*: corporate decision-makers should be motivated by commercial rather than tax considerations;
6. The system should be *sufficiently flexible and dynamic* to ensure that the tax rules keep pace with technological and commercial developments;

¹⁹²Henry H. Perritt, Jr., *The Internet is Changing the Public International Legal System*, at <http://www.kentlaw.edu/cyberlaw/perrittnetchg.html> (last visited Feb 17, 2001 9:46:18 PM).

¹⁹³ Perritt, *Economic Sanctions in the New World Order: a New Role for the Internet?*, 13 WORLD BULL. 161 (Sept-Dec 1997).

¹⁹⁴ E. C. Lallana, *supra* note 50, at 47.

7. Any tax arrangements adopted domestically and any changes to existing international taxation principles should be structured to ensure a *fair sharing* of the Internet tax base among countries, especially as regards division of the tax base among developed and developing countries.
8. It appears that the criteria can very well be met under existing Philippine tax laws and principles:

One. The rule of taxation shall be uniform and equitable.¹⁹⁵ The rule of uniformity and equality of taxation is not infringed by the imposition of a flat rate,¹⁹⁶ such as the VAT of ten *per centum* (10%) or some other uniform global rate on applicable Internet transactions, rather than a graduated tax. Considerations of administrative convenience and cost afford an adequate ground for classification. The same considerations may induce the legislature to impose a flat tax that in effect is a charge for the transaction, operating equally on all persons within the class regardless of the amount involved.¹⁹⁷ Equality and uniformity in taxation means that all taxable articles or kinds of property of the same class shall be taxed at the same rate. The taxing power has the authority to make reasonable and natural classifications for purposes of taxation.¹⁹⁸ A reasonable classification should be in terms applicable to future conditions as well.¹⁹⁹

Two. Administrative feasibility is a basic principle of a sound tax system to which the Philippines abides. It means that tax laws should be capable of convenient, just, and effective administration. Each tax in the system should be clear and plain to the taxpayer, capable of uniform enforcement by government officials, convenient as to the time, place, and manner of payment, and not unduly burdensome upon, or discouraging to business activity.²⁰⁰

¹⁹⁵ CONST. art. VI, sec. 28 (1).

¹⁹⁶ *Gomez v. Palomar*, G.R. No. 23645, October 29, 1968.

¹⁹⁷ *Id.*

¹⁹⁸ *City of Baguio v. De Leon*, G.R. No. 24756, October 31, 1968.

¹⁹⁹ *Ormoc Sugar Co., Inc. v. Treasurer of Ormoc City*, G.R. No. 23794, February 17, 1968.

²⁰⁰ *De Leon*, *supra* note 79, at 12.

Three. Online purchases may entail physical importation. Public policy would seem to require that importers be informed in advance of the home consumption values (HCVs), or information values, of articles exported to the Philippines. This would prevent uncertainty, let alone the exercise of purely personal discretion, especially on the part of customs appraisers, in the matter of the ascertainment and determination of the price or value of imported articles. Furthermore, if importers are informed in advance of the HCVs or information values of articles exported to the Philippines, they can properly declare the dutiable values of their shipments and thus avoid the heavy penalties imposed for misdeclaration, if not delays in the release of goods from customs custody which entail loss of time, money, and energy.²⁰¹ The element of certainty can also be applied to claims for exemption, but the exception contained in the tax statutes must be strictly construed against the one claiming the exemption.²⁰² The law frowns upon exemption from taxation;²⁰³ the same should be construed *strictissimi juris* against the party claiming exemption.²⁰⁴

Four. While courts will not enlarge, by construction, the government's power of taxation, they also will not place upon tax laws so loose a construction as to permit evasions on merely fanciful and insubstantial distinctions. When proper, a tax statute should be construed to avoid the possibilities of tax evasion, particularly by foreign online merchants. Construed this way, the statute, without resulting in injustice to the taxpayer, becomes fair to the government. That taxes must be collected promptly is a policy deeply entrenched in our tax system.²⁰⁵

Five. Double taxation is not violative of due process. The due process clause no more forbids double taxation than it does doubling the amount of a tax, short of confiscation or proceedings unconstitutional on other grounds. The argument against double taxation may not be invoked where one tax is imposed by the state and the other by the city, it being widely recognized that there is nothing inherently obnoxious in the requirement that license fees or taxes be exacted with respect to the same occupation, calling, or activity by both the state and the political subdivisions thereof.²⁰⁶ A grant of municipal power to tax and

²⁰¹ *Commissioner of Customs v. Procter and Gamble Phil. Mfg. Corp.*, G.R. No. 56705, January 31, 1989.

²⁰² *Union Garment Co., Inc. v. CTA*, G.R. No. 16809, January 31, 1962.

²⁰³ *Phil. Guaranty Co., Inc. v. Commissioner of Internal Revenue*, G.R. No. 22074, September 6, 1965.

²⁰⁴ *Tan Kim Kee v. CTA*, G.R. No. 18080, April 22, 1963.

²⁰⁵ *Lorenzo v. Posadas*, G.R. No. 43082, June 18, 1937.

²⁰⁶ *City of Baguio v. De Leon*, G.R. No. 24756, October 31, 1968.

license is as a rule strictly construed against its exercise and in favor of the public, especially where the purpose is to raise revenue. Hence, the power when granted is to be construed in *strictissimi juris*.²⁰⁷

Six. The sources of revenue, taken as a whole, should be sufficient to meet the demands of public expenditure. Under the fiscal adequacy principle of a sound tax system, revenues should be elastic or capable of expanding or contracting annually in response to variations in public expenditures.²⁰⁸ With the heavy impact of the Internet on commercial and non-commercial transactions, the BIR has in fact responded favorably by coming up with an Exposure Draft of regulations that already address these concerns.

Seven. The fair sharing can be achieved as the country continues to adhere to international comity.²⁰⁹ This limitation on the power of taxation is grounded on the following: (1) the sovereign equality among states under international law by virtue of which one state cannot exercise its sovereign powers over another; (2) the usage among states that when one enters the territory of another, there is an implied understanding that the former does not intend to degrade its dignity by placing itself under the jurisdiction of the latter; and (3) the rule of international law that a foreign government may not be sued without its consent, so that it is useless to assess the tax since anyway it cannot be collected.²¹⁰ Our own fundamental law has adopted the generally accepted principles of international law as part of the law of the land.²¹¹

CONCLUSION

That the Internet is inherently borderless does not call for a change in the basic principles of taxation. Yet for these principles to maintain their effectiveness, current tax laws need to be upgraded and tax authorities updated. The focus must shift from expansive legislation and aggressive enforcement to rationalization and harmonization among governments whose borders contain the

²⁰⁷ *Everett Steamship Corp. v. Municipality of Medina*, G.R. No. 21191, April 30, 1966.

²⁰⁸ *DE LEON*, *supra* note 79, at 11.

²⁰⁹ International comity refers to the courteous and friendly agreement and interaction between nations. *Id.* at 46.

²¹⁰ *French Republic v. Jefferson County*, 252 S.W. 124.

²¹¹ CONST. art. II, sec. 2.

sellers, buyers, and all the shifting points in between.²¹² It is urged that a truly global, international agreement on the taxing of Internet transactions be immediately forged, without regard to the mindset or narrow interests of the legislators.

Exploiting the full potential of the Internet in the years to come will have profound impacts in the individual sectors of our economy as well as for macroeconomic performance and global legal and economic policies. Productivity and economic growth will rise as a consequence of more efficient supply and distribution, better access to information, lower transaction costs and barriers to entry, greater value added to goods and services, and enhanced welfare. Much needs to be done to increase user and consumer trust, improve access to the Internet structure, and create a stable, predictable, and unified tax environment.

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²¹² "If I'm So Empowered, Why Do I Need You?": Defining Government's Role in Internet Electronic Commerce, *supra* note 44.