

³¹ The submissions were received from Communications Alliance, CTN, Optus, TEDICORE and Telstra. The submissions

are available from http://www.dcita.gov.au/communications_and_technology/consultation_and_submissio

[ns/customer_service_guarantee_csg_and_voice_over_internet_protocol_voip_services](#)

How e-commerce has required tax authorities to re-evaluate how they impose taxation

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Introduction

The Internet has brought with it new ways of conducting commerce and delivering new types of products. The border-ignorant nature of the Internet has made the application of traditional taxation principles, largely dependent on borders to define jurisdiction, much harder to apply. This article looks at some of the effects on taxation of e-commerce in both Australia and abroad, and the reaction by tax authorities to secure taxation revenue.

Key Taxation Concepts

Source and residence are two critical concepts used by tax authorities to establish jurisdiction for the imposition of taxation.

Residence

In essence, any income received by individuals or companies is taxed by the sovereign entity they are considered to reside in for taxation purposes. Generally, Australian residents are taxed on their income derived from sources worldwide. The residency tests used in Australia to determine residency have evolved through the common law, with tax rulings providing specific guidance. With regard to companies, determining residency for taxation purposes can be found in section 6(1) of the *Income Tax Assessment Act 1936* (Cth) which defines a "resident" to include a company incorporated in Australia, or a company that carries on business in Australia that has either central management and control in

Australia, or whose voting power is controlled by Australian residents.¹

Source

The source of income is usually defined by the geographical boundaries of the tax jurisdiction that income is earned in. In addition to this, a tax state will usually have jurisdiction to tax any income derived from business conducted within its borders. Whether income is regarded as sourced in Australia is determined by judicial rules which vary depending on the type of income involved. The starting point of any determination is the approach that Isaacs J formulated in *Nathan v Federal Commissioner of Taxation*, which is what "a practical man would regard as a real source of income".²

In addition, Double Tax Treaties between trading nations are used to settle nations' jurisdictional claims to tax where an entity is resident in one country, but income is deemed sourced in another. Generally, source income principles will take precedence over residence principles.³

Taxation Concepts and E-commerce

Due to the fact that, traditionally, a company wishing to conduct trade and commerce with a nation would require some form of physical presence, the principles of source and residency have, until recently, been adequate for determining jurisdiction to tax. However, e-commerce challenges the need for this physical requirement to engage in commerce with a country's residents. No physical presence is in fact now necessary for a foreign

company to sell products and services to Australian residents.

The Australian Tax Office (*ATO*) is concerned by this, because foreign companies can use Australia as a customer base and effectively conduct business in Australia without the ATO being able to easily tax the business conducted. Furthermore, it is possible for businesses to move their entire operations to a low-tax or tax-free state, whilst essentially retaining their Australian customer base and capitalising on efficient global logistics for delivery of tangible products. Such a scenario makes it difficult for the ATO to assert jurisdiction over the company using the physically rooted concepts of source and residency, and illustrates just how non-residents can use Australian markets (or those of any other jurisdiction) as a customer base.

Tax jurisdiction is further challenged by electronic intangible sales performed completely electronically or online.⁴ Existing tax rules worldwide are not adequately addressing enterprises utilising such e-commerce. For example, the U.S. Treasury has listed the following four major barriers to taxation imposed by electronic intangible sales:

1. identification of the buyer and seller in an electronic transaction is often difficult;
2. where the transaction takes place is often difficult to identify due to the borderless nature of the Internet;

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3. tax authorities lack enforcement powers to compel disclosure of information where the transaction involves a party who is outside their jurisdiction; and
4. there is a lack of a paper trail with an electronic transaction, which complicates tax investigation.⁵

Impacts on Taxation by E-commerce

Revenue erosion has necessitated consideration of the issue of e-commerce by tax authorities. As e-commerce continues to grow, the possibility of transactions avoiding taxation increases. In addition, companies cannot ignore the lure of low-tax or tax-free income states for basing their businesses. Ireland reduced the corporate tax rate to 12.5% for companies carrying on trading activities, and has an extensive double tax treaty network.⁶ This provides great incentive to relocate an enterprise to Ireland, receive the benefits of the lower tax rate, be relieved of double taxation, and utilise e-commerce to continue to sell to the customer base of their original tax state.

In response to this perceived threat to revenue, the ATO published the document "Tax and the Internet: Second Report".⁷ This document discusses the impacts of e-commerce on taxation, and analyses existing taxation principles and their application to e-commerce. It recognises that the application of the existing rules is problematic, since the income from a non-resident enterprise is not derived from a function or assets physically located within Australia, and finding a sufficient nexus to provide jurisdiction to tax is difficult.⁸ This highlights the difficulty in applying the existing taxation principles to the border-ignorant e-commerce marketplace, and how income derived from Australian consumers escapes the traditional application of taxation rules.

These observations by the ATO question the appropriateness of existing principles of taxation when the place of contract can be manipulated by the mechanics of the sale. Manipulation of the income source can also be achieved through

contracts drafted in such a way as to use servers located in tax friendly nations.⁹ This in-depth analysis shows the ATO's concern with foreign traders selling to Australians and its aggressiveness in looking at taxing these merchants.¹⁰

Tax authorities around the globe have recognised the potential for erosion of tax revenue, although estimates as to how much vary.¹¹ As Australia finds international e-commerce threatening national taxation revenue, the situation in the United States is compounded by e-commerce having an effect on state based trade and taxation revenue. This has resulted in the United States producing much of the commentary and proposed solutions in this area.

In the United States, sales taxes imposed by states causes the most concern. Whilst an online retailer should withhold sales tax on behalf of the state in which the consumer resides, the decision of the United States Supreme Court in *Quill*¹² means those trading companies are not compelled to do so. Thus, companies can reside in low-tax or tax-free states, but sell to any consumer in any state. An example is the entity Amazon, which is based in Delaware, a state with no sales tax. As such, the United States is experiencing domestically what countries like Australia (and also the United States itself for that matter) are experiencing from international trade utilising e-commerce.

Some individual states were quick off the mark to try and recoup lost taxation revenue. Eight states implemented Internet taxes before the U.S. Congress stepped in and enacted the *Internet Tax Freedom Act in 1998*¹³ which was initially a 3 year moratorium prohibiting new Internet taxes and prohibits discriminatory taxes against electronic commerce. However, the moratorium had a grandfather provision which allowed the continuation of Internet taxes already in place. It was later extended by 2 years, and recently further extended until 1st November 2007 by the enactment of the *Internet Tax Nondiscrimination Act*.¹⁴

The prohibition on Internet taxes is intended to encourage the growth of the e-commerce industry. Studies have shown that were widespread

Internet taxes introduced, e-commerce activity would decrease substantially.¹⁵ Conversely, it is argued that because e-commerce consumers are largely the more affluent parts of society, Internet taxes should be implemented so that these users do not escape paying sales tax.¹⁶ Indeed, because they cannot take advantage of potentially tax-free products and services, non-Internet literate persons are financially disadvantaged – an example of the digital divide in society between information literate and poor.

Unsuccessful Proposed Solutions

One of the first proposed responses to recoup lost revenue was to implement a "bit tax", where a low-impact, flat-rate tax is applied to all Internet traffic. One commentator notes that this results in a kind of 'rough justice', and has not been well received.¹⁷ It did find support in the Final Policy Report from the European Commission's High Level Expert Group¹⁸, which advocated the tax to counter the erosion of tax revenue but this was rejected by the European Commission.

Other approaches put forward for solving the issue of lost taxation revenue have been the 'Tobin Tax' which suggests a tax on international capital flows. Moreover, the Raworth Report suggested a tax of 1 cent per 100 emails sent. Neither of these proposals has received much support.¹⁹

There have also been suggestions for the United States to replace sales tax with a broad consumption tax, such as Valued Added Tax (*VAT*). However, this would require a much greater tax reform package for the United States.²⁰ Much thought is being put into capturing e-commerce taxation revenue, but ideas continue to be restrained by traditional taxation principles.

Harmonisation and Co-operation

In the same way that global copyright and patent protection has been successful by the co-operation of nations, it is difficult to see how the taxation issues arising from growing e-commerce activity can be resolved without cooperation between tax

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authorities and the harmonisation of tax principles, such as source and residency. Without such co-operation, it will be difficult to successfully implement any regime to capture taxation revenue from international e-commerce activity.

The United States has taken steps towards harmonisation of its domestic sales tax issues via the Streamlined Sales Tax Project (*SSTP*). A large number of states are co-operating to streamline sales tax administration and implementation. The *SSTP* aims to streamline sales tax at the state level, and encourage the federal government to enact legislation to override the *Quill* decision, compelling companies to collect tax on behalf of other states. This is currently impractical given the estimated 6,000 sales tax jurisdictions in the United States which any e-commerce business would need to cater for. Complying with the requirement to withhold tax on behalf of those authorities would almost certainly make e-commerce unfeasible for many small to medium enterprises.²¹ It is this compliance that the *SSTP* aims to make achievable.

On a global scale, both the United States and Australia have indicated that they will be looking to the Organisation for Economic Co-operation and Development (*OECD*) for co-ordination and harmonisation on these issues. The ATO is analysing the problems that arise from e-commerce, and is trying to work through the issues of e-commerce taxation to protect its revenue base. However, it is clear that international co-operation will be needed to achieve this aim on a global scale.

The OECD's Committee on Fiscal Affairs made the following recommendations as part of its Electronic Commerce Taxation Framework Report:²²

- the taxation principles used by governments for conventional commerce should be used for electronic commerce;
- these taxation principles should be implemented by existing rules;
- electronic transactions should not be discriminated against; and

- the taxation principles should be applied in such a way as to maintain the fiscal sovereignty of countries.

The approach of the OECD focuses on utilising existing taxation principles, rather than the creation of new taxation principles. Whilst this suggests that new taxation regimes are unlikely, it can only work through the co-operation of participating governments. Even if this is achieved, it will not prevent enterprises from using tax friendly nations as a base for their businesses, or any country which does not participate in the global effort. It is clear that since the issue is global in nature, it can only properly be dealt with by a global effort.

Conclusion

As e-commerce continues to grow, traditional taxation principles that grew out of traditional concepts of commerce are being tested and stretched. The response of the world's tax authorities has been to determine what the issues are, and look to a global effort through organisations such as the OECD to meet the challenges that e-commerce presents to them. Since the issue is global in nature, it can only properly be dealt with by a global effort.

The views expressed in this article are those of the author and do not necessarily represent the views of, and should not be attributed to, Melbourne IT or the Melbourne IT Group.

¹ Whilst section 6(1) of the *Income Tax Assessment Act 1936* (Cth) also defines residence for individuals, the focus of this article is on companies relating to e-commerce.

² (1918) 25 CLR 183 at pp 189-190

³ American Bar Association Global Cyberspace Jurisdiction Project at 172: American Bar Association Global Cyberspace Jurisdiction Project, *London Meeting Draft: Achieving Legal and Business Order in Cyberspace* (1998) <http://www.kentlaw.edu/cyberlaw/docs/drafts/draft.rtf>

⁴ See Ricci, Jonathane M., *Electronic Commerce and Non-Resident Aliens: The Internal Revenue Service Versus International Cyberspace Transactions*, 6 RICH. J.L. & TECH. 7 (Fall 1999)

<<http://law.richmond.edu/jolt/v6i2/article2.html>> at para.13

⁵ *Ibid* at para.39

⁶ Goldsmith M, *Ireland - The Place to Hold IP?* - Gilbert and Tobin Website (July)

<<http://www.qtlaw.com.au/qt/site/articleIDs/640EFACDAE8FE93FCA256DE40012383F?open&ui=dom&template=domGT>>

⁷ Tax and the Internet : Second Edition, the Australian Tax Office – cited in Hardesty, David, *Australia's Second Report on Tax and the Internet* March 19, 2000 <<http://web.archive.org/web/20030803082848/http://ecommercetax.com/doc/031900.htm>>

⁸ *Ibid*

⁹ Goldsmith M, *E-commerce: A Taxing Issue* - Gilbert and Tobin Website (May 2001)

<<http://www.qtlaw.com.au/qt/site/articleIDs/3D44ADEEEF32A47DCA256DE40018E95B?open&ui=dom&template=domGT>>

¹⁰ Tax and the Internet : Second Edition, the Australian Tax Office – cited in Hardesty, David, *Australia's Second Report on Tax and the Internet* March 19, 2000 <<http://web.archive.org/web/20030803082848/http://ecommercetax.com/doc/031900.htm>>

¹¹ See Nellen A, *Overview to E-Commerce Taxation Issues* September 2001 <http://www.cob.sjsu.edu/facstaff/nellen_a/ECTaxUpdate9-01.doc>, and also Nellen A, *Internet Business, Local Taxation & Nexus* October 2004 <http://www.cob.sjsu.edu/facstaff/nellen_a/e-commerce10-04.pdf> for discussion on how much tax revenue was lost to e-commerce. See also the article at http://www.pcworld.com/news/article/0,aid_106965,00.asp where estimates of US\$45 billion in lost sales tax revenue have been put forward.

¹² 504 U.S. 298 (1992)

¹³ Internet Tax Freedom Act, 105th Cong., 2d Session, H.R. 4328, Title XI.

¹⁴ Internet Tax Nondiscrimination Act, 108th Congress, 2d Session.

¹⁵ A reduction in Internet purchases of 24% was submitted by Gooisbee, Austan, *In a World without Borders : The Impact of Taxes on Internet Commerce* November 1999 University of Chicago <http://gsbwww.uchicago.edu/fac/austan_gooisbee/research/intertax.pdf>

¹⁶ See Lav I and Mazerov M, *A Federal "Moratorium" on Internet Commerce Taxes Would Erode State and Local Revenues and Shift Burdens to Lower-Income Households* Center of Budget and Policy Priorities Web Site <<http://www.cbpp.org/512webtax.htm>>

¹⁷ See American Bar Association Global Cyberspace Jurisdiction Project at 175: American Bar Association Global Cyberspace Jurisdiction Project, *London Meeting Draft: Achieving Legal and*

Business Order in Cyberspace (1998) <http://www.kentlaw.edu/cyberlaw/docs/drafts/draft.rtf>

¹⁸ European Commission: Directorate-General for Employment, Industrial Relations

and Social Affairs, *Building the European Information Society for Us All*, April 1997

http://ec.europa.eu/employment_social/knowledge_society/docs/buildingen.pdf

¹⁹ See discussion on these at Caslon Analytics, *taxation guide* <http://www.caslon.com.au/taxationguide2.htm>

<<http://www.caslon.com.au/taxationguide.htm>>

²⁰ See Nellen A, *Overview to E-Commerce Taxation — Guide to Understanding the Current Discussions and Debates* July 2003 <http://www.cob.sjsu.edu/facstaff/nellen_a/ECOMM.pdf>

²¹ See Nellen A, *Overview to E-Commerce Taxation Issues* September 2001 <http://www.cob.sjsu.edu/facstaff/nellen_a/ECTaxUpdate9-01.doc>

²² See Organisation for Economic Co-operation and Development: Committee on Fiscal Affairs, *ELECTRONIC COMMERCE: TAXATION FRAMEWORK CONDITIONS* (1998) <<http://www.oecd.org/dataoecd/46/3/1923256.pdf>> at 3

Scalping Protection Misleading and Deceptive – eBay International AG v Creative Festival Entertainment Pty Limited [2006] FCA 1768 (18 December 2006)

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Introduction

In a demonstration of the potentially broad scope of an action under section 52 of the *Trade Practices Act 1974* (Cth) (*TPA*) to protect a company's interests, online auction proprietor eBay brought an action against a concert organiser for misleading and deceptive conduct in relation to ticket conditions designed to prevent ticket scalping.

Facts

Creative Festival Entertainment (*Creative*) are the organisers of the annual music festival The Big Day Out (*BDO*). In an effort to prevent ticket scalping, Creative cancelled a number of tickets that were sold on eBay's online auction site at an inflated price. The reason given to the ticket holders was that they were in breach of a condition that was printed on the back of the tickets, namely:

Condition 6: 'Should this ticket be re-sold for profit it will be cancelled and the holder will be refused entry. This condition specifically prohibits ticket re-

sale through online market or auction sites.'

The tickets were originally sold in the following four different ways:

1. on the BDO website;
2. on Ticketmaster's website;
3. at Ticketmaster box-offices; and
4. at other retailers' stores.

Tickets that were sold on the BDO website before 8 November 2006 drew the customer's attention to a previous iteration of condition 6 (*old condition 6*), that stated that a ticket holder *may* be denied entry if the ticket was re-sold for profit. After 8 November 2006, the updated condition 6 (*new condition 6*), set out above, appeared on the website.

Ticketmaster's online terms and conditions of sale included a condition that all sales were subject to the promoter's conditions of sale. The sales personnel in the retail stores did not refer to Creative's conditions at the time of sale. Regardless of where a customer bought a ticket from, new condition 6 was printed on the back of the ticket.

Arguments

eBay brought the action claiming that, because new condition 6 did not form part of any of the contracts for the sale of the tickets, it was misleading for Creative to represent in the conditions on the back of the tickets that it was entitled to enforce new condition 6. With respect to condition 6 itself, eBay argued that the representation that all tickets sold for profit would be detected and cancelled was misleading because there was no way for Creative to know what tickets were re-sold for profit.

Creative contended that the new condition 6 was in effect no different to the old condition 6, which was brought to the customer's attention on the BDO website before 8 November 2006. It was argued that new condition 6, as read by a reasonable person, would mean that the ticket would only be cancelled if Creative became aware that it was re-sold for profit. Creative also contended that the conditions were sufficiently brought to the attention of the customer on Ticketmaster's website. Additionally, Creative argued that