

PASCN Discussion Paper No. 2002-08

Towards a National Tax Policy for E-commerce

Peter Lee U



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Peter Lee U

University of Asia & the Pacific

August 2002

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ABSTRACT

The internet has already revolutionized many aspects of modern business and living and promises to bring even more radical future changes. In contrast, tax laws are normally slow to changing realities. This study looks at some of the problems that electronic commerce has posed. However, taxation covers a very broad spectrum of activities so this study looks only at income and goods taxation for the Philippines. It is anticipated that trade in tangible (physical) goods with e-commerce will not introduce problems. However, trade in intangible (electronic or digital) goods can be problematic because they will be difficult if not impossible to track. Meanwhile, the BIR is likely to miss out on added income tax collections on the increasing trade in services that can be delivered electronically (especially over the internet) by Filipinos to employers and contractors who may not be registered in the Philippines, especially foreign employers.

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EXECUTIVE SUMMARY

The internet has changed many ways of conducting business, as well as the buying of goods, and promises to further change the way of life for consumers and producers in the future. While electronic commerce or e-commerce is just starting here in the Philippines, it has already reached sizable proportions in developed countries like the U.S.

But because e-commerce precisely changes, even radically in some cases, the way transactions are conducted, it necessarily has implications for tax collection. However, e-commerce can theoretically be both a threat and a boon to taxation. If harnessed well, practices like electronic filing of taxes could theoretically improve the collection efficiency of the BIR. On the other hand, electronic transactions may be more difficult to track, in part because of the potentially large volume of transactions that it makes possible. Moreover, e-commerce is less constrained by physical boundaries and individuals may in practice be transacting with parties in other countries.

This lack of boundaries in the e-commerce setting poses jurisdictional questions that the old ways of doing business never encountered. Since web addresses do not necessarily reflect true physical addresses, it may not be clear which country's tax authority has jurisdiction. Moreover, since pure dot.coms are very mobile, they can be easily moved and registered in areas that impose the least tax obligations. This has precisely posed problems for the federal tax system in the United States. There, some retail dot.coms have located precisely in states that do not or have the least in-state sales tax rate. And since they are not required to collect taxes on sales to out of state residents, this has caused some erosion of state tax revenue in many states.

Thus there is at least a bright side to being a follower. We have the benefit of observing the problems and issues that e-commerce is raising in the leading edge countries, and of learning from them. Nevertheless, it is better to anticipate potential problems than to react to them. The paper focuses specifically on income and goods taxation.

We do not anticipate significant new problems with respect to electronic commerce in good old fashion tangible or physical goods. It is possible though that there may be some erosion of sales tax revenues in cases where local consumers purchase directly from foreign merchants not registered to do business here in the Philippines. Tariffs and customs duties could still be collected theoretically on such goods however, at the border. The BIR could also elect to impose the sales tax burden on the local purchaser at this point.

Intangible (electronic or digitizable) goods however, could be problematic. These goods can now be easily bought and sold over the internet and tracking them would be

difficult if not impossible for a tax authority, especially if the merchant is a foreign one. Even if it tried to, this could raise issues of the right to privacy.

The internet and electronic commerce now also makes possible trade in services across borders that formerly would be impossible or too costly. Already Filipinos are sought after for art work (cartoons), programming, medical transcriptions, customer services, and other backroom services that could be outsourced by mother companies abroad. Once again, if these employers are not registered in the Philippines, and hence, have no legal obligation to report or withhold income of the their Filipino workers, the BIR could stand to miss out on additional income tax collections.

Towards a National Tax Policy for E-commerce¹

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Introduction

Information technology and electronic commerce are developing at a fast pace around the world. Even the Philippines is jumping on the bandwagon. In particular, we are trying to position ourselves and play on our comparative advantage: a highly educated English speaking work force, to attract new foreign investments into this new sector.

The Internet has provided a new way of life for its users. Users have the ability to search a wealth of information, goods and services at their fingertips. It is perhaps the diverse uses of the internet that spawned the numerous types of websites that allow users the ability to carry out a “normal” life without leaving the comforts of their seats much less their homes.

The growth of the internet has been amazing. It has expanded to enable persons and corporations to conduct business activities online, what is termed electronic or e-commerce. In 1997, an estimated 6% of Filipinos with internet access bought \$16 million worth of goods and services over the internet.² Lallana et al projected this figure to rise to \$38 million by 2002 and the proportion of online Filipinos purchasing on the internet to rise to 30%. This suggests that electronic commerce, if allowed to flourish, could significantly improve efficiency in economies, enhance productivity, improve resource allocation, empower consumers and increase overall long-term growth.

It is because of the tremendous growth potential in electronic commerce and concern over possible erosion of a government’s tax base that has sparked the need to discuss what has to be done. Most literature written on this issue emanate from the G7 countries specially the United States. Revenue agencies in the OECD, United States, Canada, and Australia for example, have issued their own studies on the challenges of taxation in electronic commerce.

The U.S. has even been lobbying other countries in international fora not to impose new taxes on electronic commerce. Of course, the U.S. is said to be a “net exporter” of electronic commerce. A **1998 WTO** paper states that 85% of internet revenue was generated by the US while only 62% of the users are located there. This would suggest that the US has a large interest in preventing discriminatory taxation on

¹ The author is grateful to the Philippine APEC Study Center Network for funding of the study.

² E.C. Lallana, R.S. Quimbo, and Z.B. Andam “e-Primer: An Introduction to E-commerce”, Jan. 2000, p. 5.

electronic commerce, since it stands to benefit the most from unfettered electronic commerce.

Even though the Philippines is obviously not as advanced as these countries, it is still prudent to assess the possible ramifications of electronic commerce on taxation (and thus indirectly on fiscal policy as well). This paper seeks to survey current Philippine tax law and tax policy in order to identify areas that are inappropriate for this new market paradigm of e-commerce. The study will look at the main principles and philosophy in Philippine tax law and assess their appropriateness for e-commerce. Only by understanding how electronic commerce impacts taxation can we make prescriptions that protect consumer welfare and promote the participation by Philippine firms in electronic commerce.

But before everything else, let us agree on what we mean by e-commerce. In its broadest sense, e-commerce is not new. Business has been using electronic media like telephones and faxes for many years now to conduct business. We have been transacting with banks through automatic teller machines (ATM) even longer than faxing. However, the explosion on the scene of the internet has made possible new channels of transactions and new business models. It is this new phenomenon that business and policymakers are still trying to come to grips with. Thus, in this study we will primarily be interested in this new form of doing commerce over the internet and its implications on taxation, and consequently, fiscal policy, in so far as it affects it. We will generally use electronic or e-commerce and internet commerce interchangeably in this report.

The term internet taxation can refer to many things. It can refer to the taxation of internet access. Or it could refer to the taxation of goods that are being transacted and/or exchanged over the internet. (By “over the internet” we have in mind digital/digitizable goods like books, music, software while by “through the internet” we refer to simply using the internet to order a good, as one would with the telephone for example.)

Internet commerce itself has come to be classified into three types:

1. B2C – business to consumer (online stores selling products to final consumers)
2. C2C – consumer to consumer (e.g. E-bay)
3. B2B – business to business (job recruiting, online advertising, credit, sales, market research, technical support, procurement, and different types of training) A local example here would be Bayantrade.

The internet also makes possible the exchange of services. Without the advent of internet technology, trade in services would have been impossible, or very costly; requiring physical transfer or transporting either the persons performing the services, or the buyer, e.g. tourism. Now with the internet, where the work is ‘digitizable’ or can be put into electronic format, the service can be done in one country (usually where the labor is cheaper) and just emailed to the buyer or user in another country.

Some examples of such services already being performed here are:

1. medical transcriptions
2. customer assistance or service centers (taking orders, responding to emails, call centers etc.)
3. cartoon production
4. backroom services (accounting, record keeping etc.)

E-commerce has been widely touted as a possible tool for growth. Before regulating or promoting an activity (and taxation is one tool to do this), one needs to understand the role of that activity in the economy.

The Economics of E-commerce

Before one can assess the impact of electronic commerce on fiscal policy, it would be helpful to have a theory of how e-commerce will impact the economy. Many studies have considered the benefits of e-commerce and the changes to the industrial landscape that it can bring. In this section we will summarize the main channels. But it is also necessary to look at some of the details of electronic commerce transactions, without getting lost in them however, in order to identify whether any tax leakages may result.

The most obvious benefit electronic commerce brings from an economic standpoint is arguably the efficiency gains from the reduction of transaction costs. These transaction costs can be very varied; e.g. reduction of paperwork, faster procurement between firms, convenience of shopping online for consumers etc. The combination of the Internet and information technology can cut down greatly on the time and resources needed to carry out transactions. The Internet minimizes the obstacle of physical distance. Indeed, a World Bank study has aptly described it as “globalization on steroids.” More than ever in the history of mankind, information technology can truly make the world a smaller place.

For years economic theory has held up the theoretical model of a perfectly competitive market as the ideal of market efficiency. And for years the usual hindrance to markets approaching that ideal has had its roots in barriers to entry limiting the effective number of competing suppliers. In the real world, those barriers to entry often took the form of prohibitive costs (both time and resources required) of acquiring information on the existence and product prices of alternative suppliers. Today, for more and more products, the Internet allows businesses all over the world to directly advertise their existence in a medium that is literally just a click away from prospective clients. However, one must also credit the generally more liberalized and open world economy for making it easier to sell across borders, even over the internet.

Thus there is the potential for the middleman to be cut out in many transactions. In part cutting out the middleman is what motivates the drive to develop B2B or business to business applications. If companies can source directly from their suppliers, then it

saves on the costs of the middleman. The Philippines itself can boast of a few fledgling attempts to establish such B2B exchanges that will put firms in direct contact with their suppliers.

The irony is that the explosion of easily accessible information may create a new type of middleman: the “infomediary”. As we are bombarded with huge amounts of information, we are starkly reminded of a resource that is perfectly inelastically supplied: time. There are only 24 hours in a day and it doesn’t look like that is going to change. It becomes critical to be able to wade through the ocean of information and narrow down to what is useful. Infomediaries may arise precisely to fulfill this function. Search engines like Yahoo, Google etc., precisely fulfill this role though they rely primarily on advertising revenues at the moment rather than directly charging users.

Status of Electronic Commerce In the Philippine Economy

Information technology and the practice of e-commerce are not new to the Philippines. Computerworld-Philippines reported that in 1997, Filipinos bought US\$1.6 million worth of goods and services over the Internet.³ GS Research and IDC estimates that by 2005 transaction values for ASEAN countries could reach US\$11 billion for Singapore, Thailand and Indonesia, \$10 billion for Malaysia, and \$7 billion for the Philippines. These much larger values presumably include firm to firm transactions (B2B). Nevertheless, their estimate for the Philippines is not something to sneer at, considering some of the other countries have at least twice or thrice (Thailand and Malaysia, for example) our per capita income.⁴

Meanwhile, Philippines’ software exports have been growing steadily with a compounded annual growth rate of 41% between 1993 and 1999 (see figure 1). Our programmers earned some notoriety with the “love bug virus” last year which caused extensive damage world-wide. Not as well known perhaps is the fact that Filipino programmers also played a pivotal role in developing the antidote for it.⁵ Other multinational companies like Andersen Consulting can also testify to the more positive and beneficial contributions of Philippine programmers. The company already subcontracts a significant amount of its project programming needs to its team of Philippine programmers.⁶

Theoretically, similar contracting arrangements could be done by freelance Filipino programmers. This is a concrete example of how the internet and electronic commerce has literally made trade in services cheaper. In the past, such an exchange would have been costlier either because it would have taken more time to complete and/or the parties involved would have to shuttle back and forth. Thus, such an exchange

³ “RP Internet Users: 217,000 and Rising” *Computerworld-Philippines* Oct. 15, 1998, page 1.

⁴ Julian Baum et al, “Settling Accounts”, *Far Eastern Economic Review*, Aug. 24, 2000, pp. 39-41.

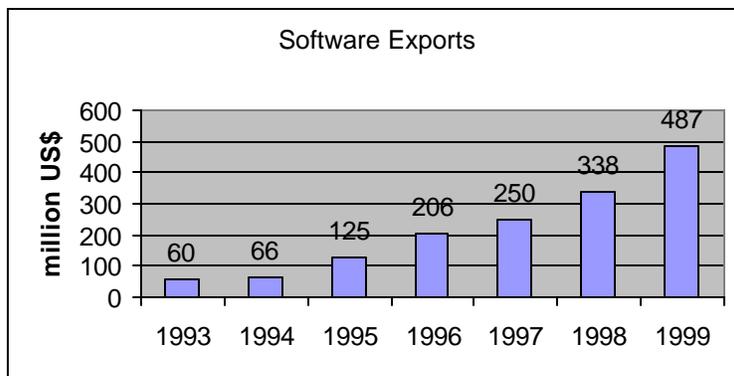
⁵ Dennis Arroyo, “Believe it or not, RP is an emerging hi-tech power”, *Philippine Daily Inquirer*, November 22, 2000.

⁶ G. Pierre Goad et al, “White Collar Gold Mine: AOL, other giants ship jobs to Asia,” *Far Eastern Economic Review*, September 2, 1999, p. 12.

might have never occurred in the past, or at least it would have been discouraged due to the cost. From a tax perspective, this arrangement by Andersen Consulting certainly contributed to tax revenues: from business taxes generated by this activity as well as both corporate and individual income taxes (of both Andersen Consulting and its employees).

However, such an exchange also raises the issue of how the Bureau of Internal Revenue (BIR) would be able to monitor and tax such income earned by Filipinos who in this case might not have to leave our shores to earn it. When a legally incorporated or registered firm here, for example Andersen Consulting's Philippine subsidiary, organizes the local labor component then it shouldn't be a problem. Precisely because they are legal entities here, they would presumably abide by existing local tax laws and report income earned by Filipinos to the BIR (much less income it itself earns). However, when the contracting party does not have a legal presence here, it would have no incentive nor requirement to report such income, much less withhold and forward payroll taxes to the Philippine BIR. The only consolation here may be that free lance work is likely to be relatively small in volume and value.

Figure 1. Philippine Software Exports (1993 – 1999)



Infrastructure Hurdles

But for electronic or internet commerce to flourish, the necessary infrastructure for information technology must first be there. This infrastructure is both physical and 'soft'. The physical infrastructure refers to the technology, equipment, wires, network etc. required to conduct e-commerce over the internet.

The size of the market in e-commerce depends on the number of people connected to the Internet. This is a function of the number of personal computers and Internet hosts, and thus they can serve as indicators of an economy's connectivity. Here we lag behind our neighbors Thailand and Malaysia. In terms of internet subscribers, there were an estimated 150,000 subscribers in 1998, which did not compare too unfavorably with some other countries. (see table 1)

The rate of growth of Internet Service Providers or ISPs has been encouraging though. From 19 ISPs in 1995, that number quadrupled to 88 in 1996 and to over 160 by

the end of 1997. It is estimated that 25 (in early 1997) of these providers had a primary connection to the global internet. This small ratio of primary connection again is a reflection of the deficient telecommunications infrastructure. Nevertheless, the growth in the number of ISPs itself is an indication of the potential demand. Cable internet was also introduced recently in the country. The three main providers here are Destiny Cable, Home Cable, and Sky Internet. All three offer the service with regular cable tv programming.

Table 1: Cross Country Comparison of Number of Internet Subscribers

Country	Number of Internet Subscribers (1998)
Japan	5,100,000
Taiwan	800,000
Hong Kong	400,000
China	320,000
South Korea	200,000
Philippines	150,000
India	100,000
Singapore	100,000
Thailand	100,000
Malaysia	60,000
Indonesia	30,000

Source: Connally (1999)

Paul Budde Communications, an industry consulting company, estimates that the average number of users per account in the country is three, which would put the total of users at potentially 450,000. However, a survey on internet usage conducted by the Philippine Communications Satellite Corporation (Philcomsat) found that most subscribers were unhappy with their current service due to frequent disconnections, difficulty in accessing (busy signals), and slow downloading times. As for usage pattern, most of the internet usage in the Philippines is accounted for by electronic mail (88%) Web surfing is second (60%), followed by internet chatting (29%) and newsgroups (17%).

In general, Budde Communications expected Asia's internet subscriber rate of growth to be much faster than the United States or Australia's as a greater proportion of Asia's population is under 25 as compared to these countries. About 50% of the Asia/Pacific population is under 25 while that proportion is only 26% and 28% respectively for the U.S. and Australia.

Results from an Internet Domain Survey sponsored by the Internet Software Consortium showed that the number of hosts in the Philippines domain is still a relatively small number. (see table 2)

Table 2 Philippine Domain Survey

Domain	.ph domain
Number of Hosts	9,942
All Hosts	10,019
Duplicate Names	77
Level 2 Domains	9
Level 3 Domains	344

Source: Connally (1999)

Payment infrastructures are also vital to the success of e-commerce. Even in the U.S. it seems that an initial stumbling block for consumers to buy online is a distrust of the security in sending their credit card information over the internet. Here in the Philippines, another problem precedes even that. In a conversation with some iAyala executives for example, the complaint was that credit card penetration was low to begin with in the Philippines. The number of persons with credit cards were low and so limited the number of potential buyers since credit card payment is the main facility employed in e-commerce at the moment. On the bright side though, the situation has prompted firms to explore other forms of electronic cash.

One popular form of electronic cash is actually pre-paid cards. Customers pay in advance to their account and the firm deducts the cost of services as the customer consumes them. Pre-paid cards have caught on in a large way with cellular phone users. Pre-paid users seem to favor doing away with the monthly bills that this arrangement makes unnecessary. They have also started to proliferate for internet access and even the usual landline telephone subscribers. But because prepaid accounts are anonymous, transactions done by them are going to be very difficult if not impossible to trace. This may not necessarily be desirable from a tax authority's point of view.

No less important are soft infrastructures like the institutional arrangements, legal frameworks etc. that make possible these transactions. Taxation would precisely be one important component of legal framework.

The bottomline of this section is that there are infrastructure obstacles that must be hurdled before Philippine electronic commerce can really take off. Thus, taxation is unlikely to be an immediate pressing issue in e-commerce. Whatever amount of tax revenue gain or leakage, is unlikely to be significant in the short run. In other words, the Philippines still has time to think through its policies on e-commerce taxation. Hopefully it will be able to adopt sound policies.

To Tax or Not to Tax

We begin with a short general background of taxation. Taxation (and tax collectors) has been much maligned in popular literature. Taxes have been immortally associated with other dreaded occurrences like death (for example, Mark Twain's: "There are few things certain in life, death and taxes."). To collect taxes presumes the existence

of authority to impose and collect it. In most cases, this authority is wielded by the state or government.

The political science and history literature is probably the better source for understanding the development of the state and government. Among economists, Adam Smith, the father of economics, recognized that the market would have problems providing certain classes of goods that suffered from the free rider problem called public goods. This function he thus ascribed to the state. He of course also recognized the need for government to enforce contracts and arbitrate disagreements between men in case of conflicting claims, and to maintain peace and order and national defense (arguably public goods also). In modern society, the economic role of the state has expanded to include administration of monetary policy, social services, business regulation (e.g. competition policy and fair trade laws) etc.

The efficiency of free markets is premised on the absence of externalities. The presence of either positive or negative externalities can cause inefficient allocation of resources because agents do not internalize fully the costs or benefits of their actions. For example, polluters may over-engage in their pollution activities if they are not made to face the social costs that they impose on others. A (Pigovian) tax is often proposed in the literature as one avenue to correct for this. Thus taxes can theoretically also be used by fiscal authorities to adjust for externalities or as a revenue source to compensate those harmed by it.

But if we accept the fact that a government is needed in society, and this idea is certainly uncontroversial except for the true anarchist, then such a government needs to be funded. Taxation is the primary way of doing this in most countries. Hence, it has also been said that taxation is the price we must pay for a civilized society.

Though different societies may agree on the need for a government and taxation, there are many ways to implement this. And so tax systems vary from country to country. However, there is wide consensus among economists and social philosophers on the desirable features that a tax system should have. Among these are:

1. Equity – Everyone should pay their fair share.
2. Minimize distortions in the economy.
3. Amenable to pursuit of economic stabilization and growth objectives.
4. Transparency, fair and non-arbitrary administration of tax system.
5. Administration and compliance costs should be as low as possible.

These objectives may go against one another and tax authorities may sometimes need to trade off the pursuit of one objective for another. For example, the public finance literature has long recognized that lump sum taxes that do not depend on the level of income are less distortionary than taxes that alter the relative prices of commodities (such as sales taxes). Moreover, lump sum taxes impose no excess burden on taxpayers.⁷

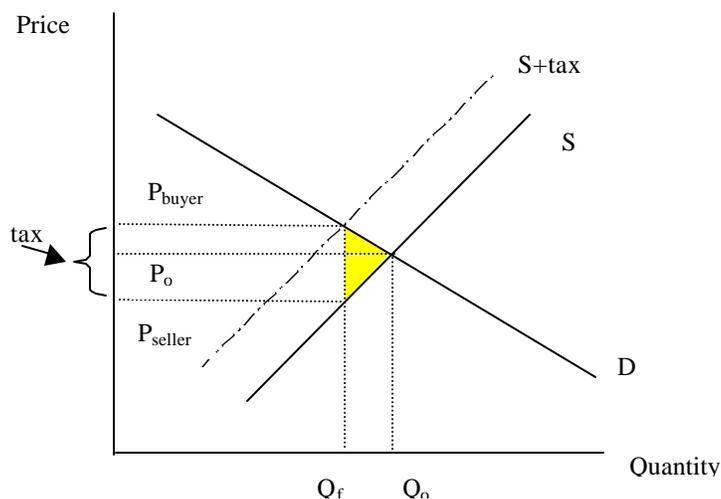
⁷ For an elementary treatment of the basic economic theory of taxation, there are a number of excellent textbooks. See for example “Public Finance” 3rd ed. by Rosen (1992).

However, lump sum taxes may be perceived as unfair or even regressive, and thus are politically impractical. On the other hand, if lump sum taxes are a function of income, then eventually taxpayers will recognize that such a tax amounts to a tax on labor time, and thus it distorts the relative price of labor to other commodities.

The branch of the public finance literature on optimal taxation is concerned with the question of the optimal configuration of commodity taxation to maximize consumer welfare; i.e. minimize excess burden. While one might think intuitively that a uniform ad valorem tax that preserved the relative prices of commodities would be optimal, Ramsay (1927) demonstrated early on that such was not the case. In fact taxes should be levied on commodities in inverse relation to the respective elasticity of demand; i.e. the more elastic the demand, the lower the tax rate.⁸

The elasticity of demand and supply is also a critical factor in determining the tax incidence; i.e. whether the seller or the buyer suffers the greater change in price from the imposition of a tax. In general, a buyer/seller with a more inelastic demand or supply will tend to bear the greater tax incidence. The principle is well known and is shown in the figure below (see figure 2). It can be seen here that in general, both buyers and sellers share in the incidence of a tax. By experimenting with differently sloped demand and supply curves, it is easy to establish that steeper (more inelastic) demand curves imply that buyers will bear a greater burden (as measured by the difference $P_{\text{buyer}} - P_o$). The same is true for the case of a seller except that their tax incidence is measured by $P_o - P_{\text{seller}}$.

Figure 2: Tax Incidence



The above figure also demonstrates that a tax always introduces inefficiencies in the form of deadweight loss (shaded triangle). This deadweight loss represents consumer

⁸ See Rosen (1992) pp. 334 to 335 for example.

and producer surplus that would have accrued to either or both producer and consumer in a tax-free market but are no longer enjoyed with the imposition of a tax. However, this may be the price we must pay for a government.

Tax Implications of E-commerce

The internet facilitates international trade at heretofore unimagined scale. Now even ordinary households and individuals can import (or even export) goods and services. Small and medium scale enterprises are enabled to reach more markets than before.

The means of delivery of some goods and services will change. One specific issue that already is posed; what if software manufacturer elects to sell computer time (i.e. rent or lease) for use of software than actual sale of software. A side-issue here is the switch from a physical product (software on diskettes or cd-roms) to digital form

Also, the internet does not necessarily provide a physical address. Thus it may be difficult to determine tax jurisdiction or what tax treaty applies.

As will be discussed at greater length later, internet commerce also replaces some physical goods with digital goods, whose transactions may be harder to trace.

Coupled with this is a trend also towards increasing use of electronic cash, which is untraceable. An example is the use of prepaid phone cards.

Pure dotcom operations pose other taxation dilemmas as well. One issue concerns the 'nexus' or the taxable presence of such an organization. The income of a foreign corporation is taxable if it has a permanent establishment in the Philippines. Examples of what constitutes permanent establishment include the following: a factory, place of management or physical presence, a branch, an exclusive agent. Internet commerce now allows a foreign corporation to sell to Filipinos without setting up any of the above permanent establishments. Buyers can connect directly to the foreign companies' websites which could be hosted on servers in or out of the Philippines. The question this raises is whether a website constitutes a permanent establishment. The opinion of some lawyers is that it does not, since a website is not a person, it cannot be considered an agent.

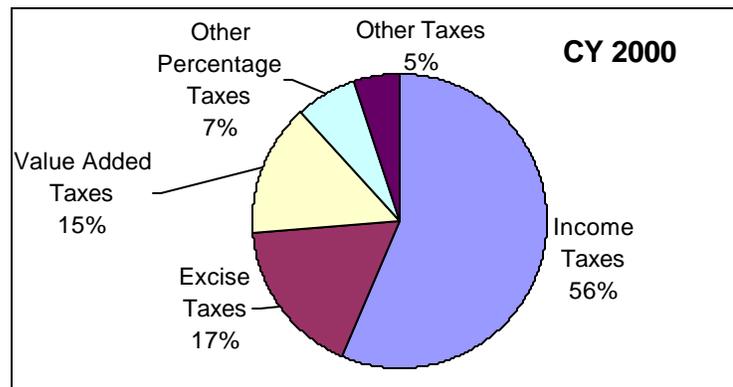
A related question is also whether a webserver constitutes a permanent establishment. The opinion of some lawyers is that it may or may not. There is also the question of whether the activity of the server is preparatory or auxiliary.

The most common types of taxes are income taxes (which may be on individual and/or corporate income, sales and excise taxes (which are taxes on goods), estate taxes (which are taxes on property and wealth). In the case of e-commerce, the most likely type of taxes with which we will be concerned will be taxes on goods. Ecommerce may

possibly have ramifications on income tax as well, as when trade in services made possible by internet generates income for Filipinos.

In the Philippines, the bulk of tax revenues are collected by the Bureau of Internal Revenue (about 78%) while the Bureau of Customs accounts for around 21%. All other government agencies collect the balance, a rather insignificant 1%. For the BIR, Figure 3 below shows the breakdown of its tax revenue collection by tax category. Thus income taxes are the most important class of taxes collected by the BIR.

Figure 3: BIR Tax Revenue Distribution



Source: BIR

Income Taxes

There are many possible forms of income but the most common forms are:

- Compensation income
- Gross income from business or the exercise of professions
- Gains from dealing in property
- Interest
- Rents
- Royalties
- Dividends
- Annuities
- Prizes and winnings
- Pensions

All citizens are subject to individual income tax. Resident citizens are taxed on their income from all sources within and outside the Philippines. Non resident citizens and aliens (whether resident or not) are taxable only on income arising from sources within the Philippines. Domestic corporations are taxable on all income derived from sources within and without the Philippines. Foreign corporations, whether or not engaged in trade

or business in the Philippines, are taxable only on income derived from sources within the Philippines. Passive income (interest, royalties, winnings, prizes etc.) is in general subject to a final tax of varying rates.

The principle of taxation is that as long as the Philippines has jurisdiction over either the source of income, the person or the property, then the Philippine government can exercise its power of taxation.

Taxes on Goods and Services

Besides income taxes, this paper will focus on the two main taxes on goods and services which are the value-added tax (VAT) and excise taxes.

VAT

The VAT or value-added tax system has been adopted in more than 70 countries around the world. It was introduced in the Philippines in 1988. It has been amended through the course of the years with the most controversial amendment probably being RA 7716 of 1994, which was more popularly known as the Expanded Value-Added Tax (EVAT). Following that, RA 8241 was passed to refine it further and this came to be known as the Improved Value-Added Tax (IVAT). The Comprehensive Tax Reform Package or RA8424, the Tax Reform Act of 1997, which amended the entire National Internal Revenue Code, also contained some minor amendments of VAT.

The VAT taxes only the value added of the firm, or the excess of its sales over purchases of goods from other business firms. The VAT paid by sellers on their purchases from other businesses is credited towards the VAT due on their sales.

The VAT is applicable to all persons who sell goods or services in the course of their trade or business with gross annual sales or receipts exceeding P200,000. The VAT applies to those importing goods as well, whether for business or otherwise.

Some sales however, are subject to zero percent (0%) rate, such as export sales. This is of special interest to us because electronic commerce may give rise to Filipinos selling goods to foreigners.

The VAT payable is computed as the excess of output tax over allowable input tax. Output tax is the value-added tax on the sale or lease of taxable goods or services while input tax is the value-added tax paid on importation of goods or local purchases of goods and services.

The steps in computing the output tax are:

- Step 1: Determine the Total Invoice Amount of taxable goods and services
- Step 2: Determine “deemed sale” transactions, which are goods taken out of the business for personal use or consumption
- Step 3: Determine the Allowable Discounts and Sales Returns and Allowances
- Step 4: Add the amounts in Steps 1 and 2 and deduct the amount in Step 3 to arrive at the net taxable sales/receipts
- Step 5: Multiply the amount arrived at in Step 4 by 1/11 to determine the *output tax*

Computation of the input tax is roughly similar. The steps are:

- Step 1; Determine total purchases of goods and services from VAT-registered suppliers duly supported by VAT invoices
- Step 2: Determine total amount of allowable purchase discounts and purchase returns and allowances
- Step 3: Deduct amount arrived at in Step 2 from amount in Step 1.
- Step 4: Multiply by 1/11 the amount arrived at in Step 3.
- Step 5: Determine value added tax paid to Bureau of Customs (BOC) on importations. Include only VAT payments duly supported by BOC official receipts.
- Step 6: Add the amounts arrived at in Steps 4 and 5.

Sales invoices or receipts are critical documents for claiming input tax credit. It is important to note that input tax is allowable only if the following basic information is indicated in the duly registered receipts or sales invoices:

- a. Name address of seller
- b. Taxpayer Identification Number (TIN) of seller suffixed by “V” or word “VAT”
- c. Date of transaction
- d. Serial Number of Sales Invoice/Receipt
- e. Quantity, unit cost and description of merchandise or nature of service
- f. Name, TIN, business style, if any and address of the VAT-registered purchaser, customer or client.
- g. Word “zero-rated” imprinted on the invoice covering zero-rated sales
- h. Invoice value or consideration
- i. BIR authority/permit to print

A cash register machine tape issued to a VAT-registered buyer by a VAT-registered seller from a machine duly registered with the BIR can also take the place of a regular sales invoice. The name and TIN of the purchaser must be indicated on the receipt and authenticated by a duly authorized representative of the seller in this case.

The key implication is that for business to business transactions the incentives are in place for each business to demand receipts or invoices in order to be able to claim input tax credit later on. It is a different situation altogether with business to consumer

transactions, as the latter may not necessarily have a need for receipts or invoices, they may not particularly care to demand one.

Excise Taxes

Excise taxes are taxes on the following categories of goods manufactured in the Philippines or imported:

1. alcohol products
2. tobacco products
3. petroleum products
4. mineral products
5. miscellaneous articles (automobiles, jewelry, perfumes and toilet water, cinematographic films, saccharine, fireworks, yachts and other vessels for pleasure sport)

Except for petroleum products, the other exciseable goods are subject to VAT as well; i.e. the excise tax is in addition to the VAT.

In general, the following persons are liable for excise taxes on the above products:

1. Manufacturer
2. Importer
3. Owner/Possessor

Excise taxes may be specific or ad valorem. A specific tax is one imposed and based on the weight, volume capacity, or some other physical unit of measurement; e.g. proof liter for liquor or kilogram/pack for cigarettes. On the other hand, an ad valorem tax is an excise tax imposed and based on the selling price or other specified value of the article.

Electronic commerce is not expected to significantly affect adversely excise tax collection. The reason is that most goods subject to excise taxes are physical goods. Moreover, these goods are taxed upon removal from either the place of production, customs custody, or the bonded warehouse. For many of these goods, there is a BIR office on the production site and the excise taxes must precisely be paid before the items can be taken out. In fact, a requirement for BIR registration in these cases before the business can operate is to submit blueprints of the plant layout specifically showing the location of the on-site BIR office. Certification on the calibration or metering devices for the product is also required.

The only good subject to excise tax that could conceivably be digitized is cinematographic films. In fact the technology exists already to digitize films. However, downloading these over the internet at current broadband levels takes a disproportionate amount of time (unless they are very short) and thus will discourage for now high traffic of films over the internet.

Tax Collection and Auditing Mechanisms

The Philippines has adopted a 'self-assessment voluntary compliance' system. This means that the taxpayer calculates the tax himself (possibly with the help of an accountant), fills up the tax return, and files it with the designated tax office together with any tax payment due. The BIR for its part, may audit returns when it deems warranted. This may sometimes result in additional taxes payable or deficiency taxes in case the taxpayer's self-assessment was erroneous or fraudulent. The taxpayer is then given a period within which to rectify the error and pay the deficiency tax, otherwise the tax becomes a delinquent tax.

Tax collection under a self assessment system may be divided into two methods: tellering and collection enforcement. Telling refers to designating certain commercial and government banks as Authorized Agent Banks, who together with Revenue Collection Agents, receive the over-the-counter tax payments of taxpayers. Collection enforcement on the other hand, is the collection of deficiency and delinquency taxes through audit or investigation.

The self-assessment approach is widely adopted by many countries, including the United States for example. It is a practical approach, given that in most countries, the number of taxpayers is probably far too many for revenue collection agencies in the respective countries to audit 100%. Aguirre (2000) admits as much, pointing out also the limited resources of the Philippine BIR.⁹ Aguirre cites for instance that while from 117,883 taxpayers in 1947, there were 7,555,966 returns filed in 1998.

At the same time, the Philippines also adopts a withholding tax system (also known as Pay-As-You-Earn) with regard compensation income. Here the employer withholds a certain amount as partial advance income tax with each paycheck. Come tax time the employer issues the employee a certification of how much has been withheld (the W-2 form in the Philippines). The taxpayer attaches this document when he files his tax return and the amount is credited towards the total income tax due. If the tax due is greater than the amount withheld, then the taxpayer pays the difference. If the amount withheld is greater than the tax due, then the taxpayer receives a refund.

The withholding tax system in effect makes the employers collection agents of the BIR and shifts some of the burden of collection to the private sector. Instead of collecting from all the workers in the labor force, the BIR reduces the collection points to a more manageable number, the employers. This is a process termed as intermediation in the tax literature.

⁹ Aguirre, Estelita "The Philippine Tax Collection System", *The Philippine Revenue Journal*, BIR Manila, March – April 2000, p. 12.

It is an interesting historical note that the BIR did not always collect taxes.¹⁰ When the Bureau was established in 1904, taxpayers were required to file and pay their taxes to their City or Municipal Treasurers. This practice went on for fifty six years before the BIR fielded its first Revenue Collection Agents in 1960. These were posted in the City and Municipal Halls of the country and took over from the City and Municipal Treasurers the task of receiving tax payments.

Then President Marcos enacted Executive Order No. 206 on January 9, 1970 which directed the Central Bank to receive tax payments through duly accredited Agent Banks. The system was inaugurated in 1971 and originally required the taxpayer to file his return first with the appropriate BIR office where he is issued a Revenue Tax Receipt (RTR) stating the amount of tax he must pay. He then takes this RTR to an Authorized Agent Bank and pays the required tax. The bank issues a Confirmation Receipt (CR) to the taxpayer, who then returns to the Revenue District Office of the Bureau for posting of his payment. For this reason, it was also called the RTR/CR system.

TOTAL COLLECTIONS (in Billion Pesos)					
Sources	1994	1995	1996	1997	1998
Voluntary Compliance	181.07	202.68	247.36	310.53	335.34
Collection from Enforcement	5.18	8.66	8.94	3.86	1.99
Collection from Del. Accts	0.38	0.14	0.19	0.15	0.32
TOTAL	186.63	211.48	256.49	314.54	337.65
% of Vol. Compliance	97.0%	95.8%	96.4%	98.7%	99.37%
% of Enforcement	2.8%	4.1%	3.5%	1.2%	0.67%
% of Delinquent Accounts	0.2%	0.1%	0.1%	0.1%	0.1%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

In 1991, the RTR/CR system was streamlined to do away with the RTRs and CRs. The New Payment Control System (NPCS) allowed taxpayers to file and pay directly with the Accredited Agent Banks. The banks would then validate the taxpayer's return and remit the payment to the BIR through the Bangko Sentral and transmit all the returns filed with them to the BIR.

It would be helpful to survey how the three largest classes of taxes (income, VAT, and excise) are collected even in the old world of "manual" transactions. This would allow us to more easily imagine later on how taxation might occur in an electronic world. We say imagine because while the e-commerce act has technically started us on the path to electronic document acceptance the author has not found any BIR documents besides those listed in the Annexes that spell out new procedures for auditing electronic transactions. Presumably the old manual world procedures will still be applied to the electronic counterparts. Indeed, the survey suggests that there will not be any new

¹⁰ Ibid, pp. 13 nn

accounting concepts introduced by electronic commerce. Only the medium of presentation will change. Excise taxes have been sufficiently treated above and is not likely to be of particular concern with respect to electronic commerce so we will not dwell on it further here.

Income Taxes Again

Compensation Income

Individual income may be from two sources: compensation or business income. There should not be a problem with individual compensation income taxes for as long as the employers are legally registered domestic businesses. In this case, the employer will withhold part of its employees' income as income tax. At the end of the year, the employer issues a W-2 form that the employee in turn attaches to his/her individual income tax return as proof of tax withheld. For a person earning purely compensation income of the same amount each month, it is in fact possible to withhold the precise amount of taxes so that he/she does not owe nor will have overpaid any amount by tax time.

A problem may exist where the employer is not a domestically registered corporation and consequently, not required to collect withholding taxes on the employees' salary on behalf of the BIR. Such an employer-employee relation could have been possible even in the days before electronic commerce. One can imagine for example, foreign companies contracting a Filipino correspondent to report or analyze local developments even before e-commerce was heard of. Arguably though, e-commerce makes such long distance work relationships even easier and they may proliferate more now than before. The nature of programming work for example, makes it very feasible for Filipino programmers now to free-lance for employers abroad. Other services that are similarly knowledge based may be amenable to such arrangements as well. Unless the employee himself volunteers his income information to the BIR, it is unlikely that the BIR will be able to collect the appropriate income tax in these cases. Furthermore, precisely because these foreign businesses are not registered locally, it is difficult if not impossible to determine the total numbers of such workers or their earnings.

Business Income

The key issue with regard business income seems to be whether or not the transactions involve physical goods or intangibles (either electronic good or a service) and the company is locally registered or not. It is best to start with a discussion of the business model for a manual world and from there the possible complications with electronic commerce could be more readily seen later on.

Traditionally, a business would have to be registered at least with the BIR, Department of Trade and Industry (DTI) and the pertinent local government agencies (e.g. sanitation and health etc.) if a single proprietorship. Corporations and partnerships must additionally register with the Securities and Exchange Commission (SEC). To print

books of receipts and invoices would require first a permit from the BIR. Moreover, the BIR would require the business to maintain certain accounting books and ledgers comprising an accounting system. These constitute the basic raw material with which the BIR can audit (when warranted) the firm to determine the correctness of tax paid. Figure 4 presents a schematic diagram of this basic accounting system.

It can be seen from figure 4 that receipts and sales invoices are the workhorses of tax determination. They are the basis for computing the sales revenues of the business. On the other hand, invoices and receipts issued by suppliers are needed to determine the expenses of the firm. In business to business transactions (even of non electronic commerce) this serves as a lever for tax collection. Since each business would want to have its expenses deducted for income tax credit purposes, there is a built in incentive for businesses to demand the proper invoices and receipts. The VAT system provides an added incentive in that businesses would need the invoices for their purchases to compute for their input VAT credit. These incentives are generally not present however in purchases by final consumers as the latter generally do not have the option to deduct their expenses for tax purposes or claim input VAT credit.

Similarly, businesses have an incentive to collect the withholding tax on its employees' salaries, otherwise such salaries would not be recognized as expenses. This would inflate its income and increase its income tax liability.

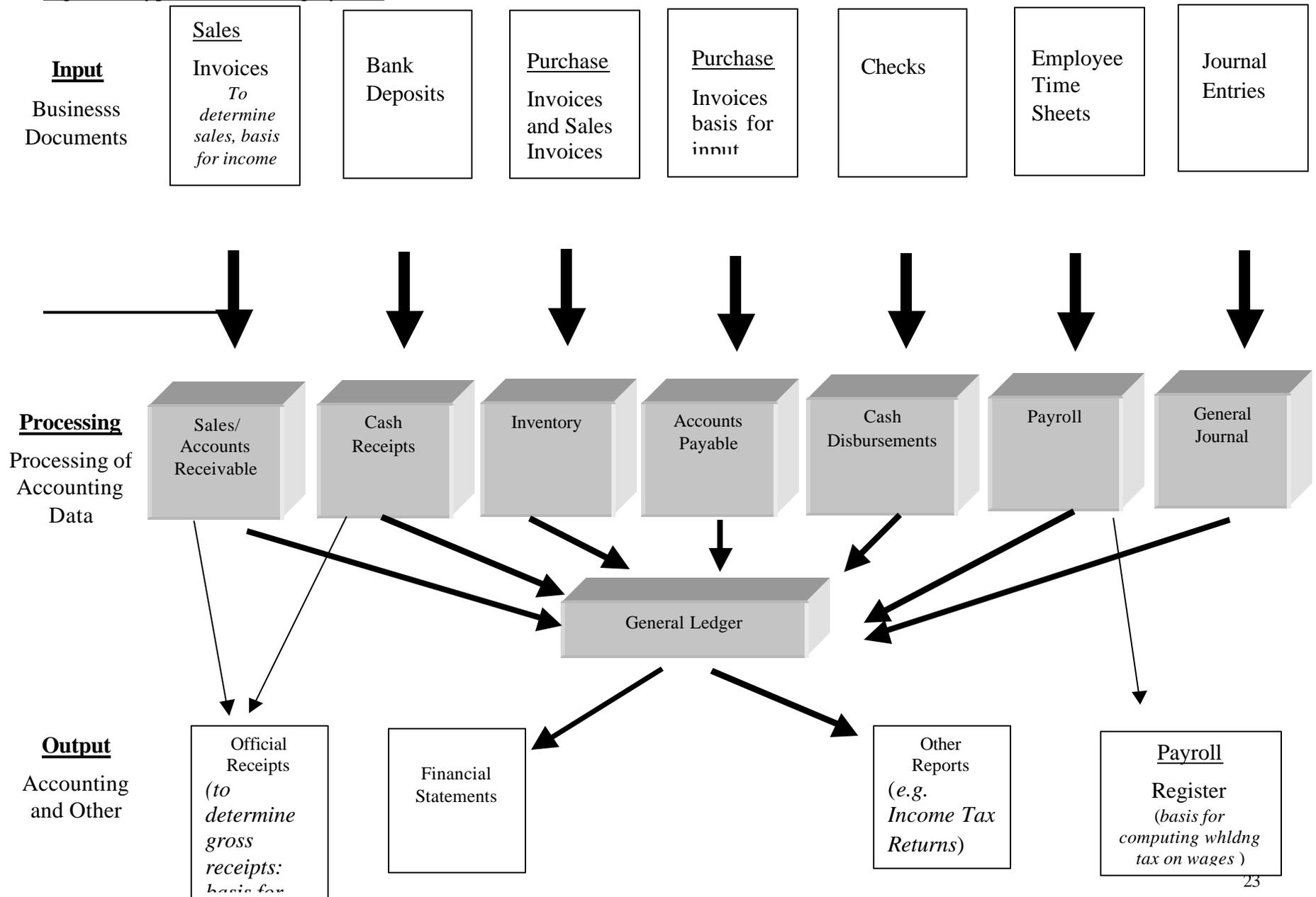
From time to time, the BIR may audit the books of the business. This does not generally occur every year and when it does audit, it may not necessarily audit all the books. Given the number of taxpayers and transactions, the BIR understandably audits randomly. Sometimes it may only audit the expenses, other times only the revenue or some other account. The auditors may also audit only a sample of transactions rather than all the transactions.

With the introduction of electronic commerce and with the passage of the e-commerce act, the way has been paved now for firms to issue these receipts in electronic form.

The BIR is not exactly a newcomer to the digital world. It has in fact been allowing taxpayers to convert their manual books of account into an electronic format for the past ten years or so already. It does set some minimum restrictions on such computerized accounting systems; basically that it conform to generally accepted accounting and auditing principles and the underlying BIR regulations and that there be an adequate back-up system.

And while we have dealt a lot with the possibility of tax leakages due to electronic commerce, its application can also help improve the BIR's collection efficiency. The BIR in fact has already started to implement its Electronic Filing and Payment System (EFPS). BIR Revenue Memorandum Circular (RMC) No. 24-2001 of May 28, 2001 and Revenue Regulations (RR) 9-2001 of August 3, 2001 spell out the

Figure 4: Typical Accounting System



guidelines of the system. Electronic filing and payment can cut down processing time and is more convenient for the taxpayer as well.

The EFPS is the BIR's response to Republic Act RA No. 8792 or the "Electronic Commerce Act of 2000", which mandated all departments, bureaus, offices and agencies of the government, as well as all government-owned and controlled corporations to be able to issue, accept, and file electronic documents in the course of their transactions with the public within two years from the effectivity of the act.¹¹ However, the EFPS is limited at the moment to the following:

1. large and excise taxpayers
2. selected non-large taxpayers
3. volunteering BIR National Office employees, and
4. thirteen BIR returns

Taxing the Internet

While we may owe the birth of the Internet largely to US government efforts to establish a network of computers for national security purposes, much of the subsequent growth is the result of spontaneous private sector activity. Perhaps this is why the Internet evokes such emotional protection from sectors seeking to keep government fingers out of it. But the only two sure things in life are taxes and death; and the former has occasioned much debate about the proper way to tax the Internet. On the one hand, governments fear erosion of tax revenue due to increasing hard-to-track electronic transactions. On the other hand, excessive taxation may nip e-commerce in the bud. Others would argue that government should not intervene at all in internet commerce.

One possible role for government intervention that might be justifiable by economic theory is that of adjusting for network externalities. Standard economic theory has long recognized the need for government provision (or to supplement private provision) in markets characterized by the presence of externalities (whether positive or negative). It has been argued that market failure might otherwise result (in the sense that an economically inefficient amount of the good will result).

Information technology has magnified the concept and role of network externalities. Clearly, the utility of much of today's technology increases with the number of other people who also possess the same technology. For example, cellphones or email would be absolutely useless if you were the only one who had them. Thus, the social benefits of making information technology more accessible may exceed the private gains reflected by market prices. In some cases, government regulation may be needed to prevent abuse of network control; e.g. refusal to interconnect with other providers and to regulate the operation of critical facilities which may have features of a natural monopoly; e.g. transmission facilities in the case of power.

¹¹ See Section 37 of Republic Act No. 8792 or the Electronic Commerce Act.

Some have made the network externalities argument within the context of another classic economic argument: the infant industry argument. This line of thinking argues that internet commerce is a developing industry and should receive protection until it is “mature” enough to compete. In this case, internet commerce should precisely not be taxed (or be accorded preferential treatment) because it is still in its early stages and needs to be “nurtured” if it is to grow and fully attain the benefits of network externalities.

On the other side are the proponents of internet taxation. In the US, the brick and mortar retailers have been crying foul over the “tax exemption” of internet purchases. They complain that the inability of the law to enforce sales tax collection on most goods bought over the internet constitutes an unfair advantage.

Information technology also has important social equity questions that impinge on the issue of internet commerce. Many fear that there may arise a “digital divide” between the rich and the poor. Since much of the employment opportunities of the future may be generated by e-commerce, it is important to enable access to information technology to as wide a population as possible. For example, participation in e-commerce will require a minimum of education. This handicaps the poor who may not in the first place have the requisite education. In a country like the Philippines where income distribution is quite inequitable to begin with, it is vital that the poor have access to information technology and the opportunities it provides.

In the meantime though, while the poor may still not have equal access to the internet, some proponents of internet taxation argue precisely that exempting the internet taxation would be a pro-rich policy. This might be especially true in the Philippines, at least in so far as purchasing over the internet is concerned. Probably, only the well to do can afford a computer with internet access and have credit cards to make such purchases. This is reflected in the still relatively low internet access penetration rates presented earlier.

The internet facilitates trade in goods. And very often this trade takes place even across borders (ex. Filipinos buying books from Amazon.com). Clearly international trade in physical goods poses no problems with respect to taxation. When the goods leave the port of origin or arrive at the port of destination, they can be subject to the export taxes and or usual import tariffs. (Although in the Philippines, imports of books and educational materials are supposed to be tax free.) It is trade in digital or intangible goods (e.g. software, music or books in electronic form) that could be problematic. These transactions are much harder to track and if they were not reported by the parties themselves, would be virtually impossible for tax collection agencies to monitor, let alone levy tax on.

But the internet also radically changes the environment of business to business commerce. The internet literally shrinks the world marketplace, making it so easy for a business to subcontract out parts to literally suppliers from all over the world. And this

means that very often tax laws in multiple jurisdictions (even countries) need to be consulted.

The US Experience

The US is unquestionably at the forefront in the adoption of information technology to commerce. Indeed, they are so far advanced over the Philippines that one is tempted to conclude that their experience would not be very helpful for us. Moreover, the US federal and state taxation system differs from our more centralized national taxation system. There, the differences among state practice in taxation, specifically sales taxation, has brought to the forefront of their policy debate, the question of how to enforce sales taxes of goods sold through the internet.

In the US, out of state merchants who do not have a “nexus” (has no employees or physical presence) in the state where the consumer who buys their product lives, are not required to collect a sales tax. For example, an online retailer based in the state of Indiana without nexus in Illinois would not be required to collect and forward sales tax to Illinois if an Illinois resident were to purchase from the retailer. This practice apparently grew out of the rules on catalog selling.¹²

Thus as the volume of internet commerce has grown, many state governments are beginning to fear that one of their key revenue bases will be eroded. State sales tax may account for a third of state revenues. What’s worse, the so-called “use taxes” are difficult to enforce. The “use tax” is a tax of the same rate as the state sales tax that the consumer is supposed to forward to the state government in precisely the case of out of state purchases where the merchant does not collect the sales tax; i.e. does not have nexus.

This tax collection arrangement is strange to say the least and of course, seriously fraught with moral hazard problems. The normal state of things in most tax systems is that the merchant or seller has the responsibility to collect the sales tax and forward to the revenue agency. Not surprisingly, the amount of use tax voluntarily paid by consumers has been very small compared to the amount of internet transactions.

It is not clear whether this “use tax” was an issue also in the old days of catalog selling. It is possible that the amount was just so insignificant that it was ignored then. However, Goolsbee (2001) cites current estimates that tax revenue loss from out-of-state catalog sales is around ten times the revenue loss from internet commerce.¹³ This suggests that the current fear may be based more on an extrapolation of internet commerce taking on much larger proportions than it currently does.

In fact, it seems that many studies for the US (as well as for other countries like Australia) agree that the short term impact of internet commerce on taxation will not be

¹² Austan Goolsbee, The Implications of Electronic Commerce for Fiscal Policy (and Vice Versa), Journal of Economic Perspectives, Winter 2001

¹³ Ibid p. 16

all that great for the simple reason that the number of people buying online is still proportionately low (although it may appear large in absolute numbers).

Lastly, we mention the US Internet Tax Freedom Act of 1998. The common misconception is that the act bats for no taxes on the internet. In fact, it merely imposes two moratoria: one, on new and discriminatory taxes on the internet; and secondly, on applying sales or other taxes to monthly internet access fees. (It is to be noted that in the Philippines, the usual 10% VAT is applied to monthly internet access fees.) Goolsbee¹⁴ rightly points out that since sales and use taxes are neither new nor discriminatory, the Internet Tax Freedom Act doesn't apply to them; i.e. no moratorium is created on sales or use taxes.

However, the US does have a special interest in international fora on internet taxation. Being way ahead of the pack in terms of electronic commerce, the US has the most number of businesses selling on the internet. Thus it wisely foresees that there will be significant temptation on the part of other countries to impose special taxes on internet commerce since it will mostly be US businesses that will suffer adversely. In fact it could be a new form of tariff protection. Thus it has been lobbying hard in arenas such as the World Trade Organization for agreements to stop special taxes on internet commerce. This is where the US Internet Tax Freedom Act does impinge on us. The act calls on the US government to demand foreign governments keep the internet free of taxes and tariffs.

In line with this, the Clinton Administration put out a position paper, "A Framework Global for Electronic Commerce" in which it takes the position that no new taxes be imposed on electronic commerce. It proposes the following principles be followed on taxation of internet sales:

1. Taxation should neither distort nor hinder commerce. A tax should not distort the incentives by discriminating by type of transaction; e.g. electronic or otherwise.
2. The system should be simple and transparent and easy to implement, minimize burdensome record keeping and costs.
3. The system should be able to accommodate tax systems in the US and other countries today.

What principles ought to govern taxation of internet commerce? All the papers agree on the basic principles that should guide authorities on the application of taxes. These principles include equitable, simple, effective, flexible and dynamic, provide certainty for taxpayers so that consequences of transactions be known in advance, and that economic distortions be avoided. The Electronic Commerce Advisory Council of the State of California in their report¹⁵ proposes the following principles:

¹⁴ Ibid p. 15

¹⁵ Electronic Commerce Advisory Council of the State of California, "If I Am So Empowered, Why Do I Need You?: Defining Government's Role in Internet Electronic Commerce November 1998.

1. Neutrality
2. Lowest Rates on the broadest base
3. Transparency
4. Ease of implementation

Under neutrality, the case is made that a tax should not discriminate on the specific channel used. That is, the same rate of tax should apply on a good whether it was purchased over the internet, or over the phone, or indeed in a face to face encounter at a physical store. The idea of the second principle is to have the tax applicable to as wide a coverage as possible so that the overall tax rate could be lower. Exempting a specific sector from taxes always means that tax rates have to be higher on other lines to compensate. The third and fourth principles are self explanatory.

The Sacher Report also agrees: "The main concern of the Group¹⁶ is not that electronic transactions will be subject to tax, but that the tax regime employed is workable and non-discriminatory."

Philippine Legislation

The landmark legislation so far as Ecommerce is concerned is clearly the E-commerce Act. The e-commerce act, otherwise known as "An Act Providing for the recognition and Use of Electronic Commercial and Non-commercial transactions, Penalties for Unlawful Use Thereof, and Other Purposes", was passed on June 8, 2000. Perhaps its main importance is the accordance of legal weight to electronic documents.

Among some of its salient provisions and objectives are:

- To facilitate transactions by recognizing authenticity of electronic documents; giving electronic documents the same "legal effect, validity or enforceability as any other document or legal writing"
- Sec. 27 Requires all government offices within two years to accept and issue electronic documents
- Sec. 28 RPWeb - Government to install an electronic online network of government offices
- Sec. 29 Puts electronic commerce under Dept of Trade and Industry
- Sec. 31 & 32 Safeguards access and confidentiality
- Sec. 33 Provides for penalties against computer crimes

With the respect to the Sec. 33, the irony is that a 'cybercrime' may have hastened the passing of the Act. It will be recalled that in the first half of 2000, a Filipino computer student had unleashed the famous "Love Bug" virus that inflicted millions of dollars of damage to computer files worldwide. While the suspect student was apprehended rather quickly, Philippine authorities were at a loss as to what crime to charge him with. The problem was that computer crimes had not been provided for in existing laws. The closest

¹⁶ Referring to the Sacher Group.

that authorities could come to pinning down the culprit was a credit card fraud law. The connection was tenuous at best and the authorities had no choice but to release the culprit. The incident underscored the need for a bill that would punish computer crimes like hacking, fraud etc.

However, it does not specify how taxation is to be done on e-commerce transactions. This is probably because the drafters of the law recognize that existing tax laws suffice and should still (and do in fact) apply in the case of electronic commerce. As BIR Assistant Commissioner Bert Pio de Roda put it, “We are not implementing new taxes for the Internet. We are only converting existing taxes to Internet.”

However, the BIR Subcommittee of the ITECC Legal Cluster have pointed out a possible loophole in Sec. 23 of the Ecommerce Act having to do with tax situs (see Annex 3):

SEC. 23. Place of Dispatch and Receipt of Electronic Data Message or Electronic Document. - *Unless otherwise agreed between the originator and the addressee (italics added)*, an electronic data message or electronic document is deemed to be dispatched at the place where the originator has its place of business and received at the place where the addressee has its place of business. This rule shall apply even if the originator or addressee had used a laptop or other portable device to transmit or receive his electronic data message or electronic document. This rule shall also apply to determine the tax situs of such transaction.

As worded, the section would seem to allow the parties to specify a place of dispatch and or receipt that would allow tax liability to be circumvented or minimized.

The Implementing Rules and Regulations of the Electronic Commerce Act, does make specific mention and emphasized that the principle of neutrality should apply to e-commerce transactions. This is found in chapter 1 “Declaration of Policy” Sec. 3 Principles of the said IRR and reads as:

d. Neutral Tax Treatment. Transactions conducted using electronic commerce should receive neutral tax treatment in comparison to transactions using non-electronic means and taxation of electronic commerce shall be administered in the least burdensome manner.

Disini (2000) reports that originally SB 1902 had contained the following provision:

Sec. 27 Taxes on E-Commerce Transactions – Value-added, sales and other appropriate taxes shall be collected on E-commerce transactions by the central and local governments concerned.

Disini (2000) notes that apparently it was determined that “since tax laws do apply with equal force upon electronic transactions, the above-quoted provision was unnecessary and was therefore abandoned during the Bicameral Conference Committee meeting.” This implies at least that the view of the law’s authors is e-commerce transactions should be subject to tax, if the corresponding old economy transaction would have been subject to tax.

For its part, the BIR has already issued Revenue Memorandum Order No. 21-2000 (see Annex 1) pertaining to the issuance of invoices, receipts, and other documents in an electronic format in a computerized accounting system. It has also started work on making electronic filing of tax returns possible. At the moment however, the BIR only has in place the system for large corporate taxpayers and BIR employees to file electronically.

In contrast to the multifarious state sales tax rates of the US due to its federalist government, a flat 10% VAT rate on purchases is applied nationwide in the case of the Philippines. Because of this, it is anticipated that the Philippines will not face the tax erosion problem of the US. But before we completely dismiss the US experience here as inapplicable to us, consider that from another angle, it is analogous. When a Filipino consumer purchases a digital good from an American seller for example, the American seller has no obligation to collect or remit sales tax to the Philippines. (There is the question to begin with of whether the sale took place in this case, in the US or the Philippines). And unless the buyer volunteers the information about his purchase, it is highly unlikely that the Philippine tax authorities will discover the transaction. This seems much like the case of out of state internet purchases in the US.

Interestingly, the BIR in a draft revenue regulation at one time considered explicitly making purchase of such intangible goods over the internet subject to 10% VAT. (see Annex 2) The BIR contemplated having the Filipino purchaser withhold the tax and remit it to the BIR. This promises to be difficult to implement, to say the least. It is hard to imagine Amazon.com, for example, allowing this to happen. It would likely simply cease shipments of Philippine orders. Furthermore, even if the Filipino buyer is able to and actually withholds the tax, it is not clear that there are sufficient incentives for him to report the same and to remit the tax. He might simply pocket the said tax. It is in fact, reminiscent of the problem that the US faces with the voluntary nature of state 'use tax' remittance, described earlier.

Moreover, the problem is not expected to be serious for sales of physical goods. If these goods are part of international trade, whether export or import, then they must pass through a port, at which point appropriate taxes can be levied. Of course, the ease of finding such goods for sale, even by merchants abroad, that the internet makes possible might lead to much greater volumes of transactions now; i.e. increase imports. Whereas in the old economy, only businesses import goods, with the internet, now even households can import directly from foreign merchants by purchasing on the internet.

It might be thought that a purely domestic sale (both buyer and seller are in the Philippines) could cause particular monitoring problems, and thus tax collection problems. There may be some basis for concern about B2C transactions. The difficulty of the "audit trail"¹⁷ in the case of an electronic transaction may make it difficult to levy

¹⁷ Actually, there should be an audit trail in the form of electronic invoices and receipts. However, this type of an audit trail may be more difficult to trace and easier to hide.

taxes. However, this is a problem that exists even in a world of entirely paper transactions. Non-issuance of receipts has always been a problem. Especially where buyer and seller have become familiar with each other and a certain level of trust has been built up between them, a receipt (whether electronic or paper) may not always be demanded. Of course, where no receipts are issued, then tax collection becomes very difficult if not impossible. Thus it could be said that the internet commerce paradigm may not introduce an entirely new class of non taxable transactions. It is not clear that it is easier in a world of internet commerce to build up the relationships of trust that enable parties to dispense with receipts. It could be argued though that the volume of such transactions will be much greater because of the ease of transacting that the internet makes possible.

This problem would be mitigated in the case of B2B transactions. The beauty of VAT taxation is that it institutionalizes incentives for truthful revelation of tax liability. In economists' parlance, it is incentive compatible with truthful revelation of tax liability. This is because a business offsets the tax it collects against the input taxes it pays on its inputs. If a firm doesn't issue receipts then it cannot claim a refund of the corresponding amount on taxes it paid on inputs it purchased.

A useful way of visualizing where taxes interact with electronic commerce is to illustrate the documents flow involved in transactions in an accounting system with journals. (see figure 4) Indeed, Figure 4 applies even to conventional commerce. The figure assumes that the business is a legally registered one with the BIR and highlights some of the main checkpoints that the BIR has on a transaction.

Typically a transaction starts with delivery of a good and the sales invoice. Sales invoices determine the amount of sales and serve as basis for income tax. Meanwhile, official receipts are issued to the buyer upon payment by the latter and determine the gross receipts that are the basis for output VAT. The purchase invoices and the receipts received when payment is made by the firm for its purchases are the basis for computing the input VAT. This in turn would be credited towards the output VAT of the firm.

Meanwhile, on the salary side of the accounting system, a firm operating in the Philippines would have time sheets or cards evidencing the amount of time worked by its employees. These are then forwarded to the payroll register, from which the human resources or personnel department of the firm will calculate wages and the relevant withholding taxes. The withheld taxes are then forwarded to the BIR.

These ingredients are present as well in an e-commerce setting. The difference might simply be that the E-commerce Act now makes it possible for many of the aforementioned documents such as invoices, receipts, etc. to be in electronic format. The BIR has in fact issued Revenue Memorandum Order No. 21-2000 providing guidelines on the issuance of receipts (see Annex 1)

Tax Competition

A survey of electronic commerce by the Economist magazine¹⁸ points out yet another possible arena of tax policy that could be profoundly affected by electronic commerce. This is the area of tax competition: when countries try to outdo each other in reducing tax rates e.g. corporate income tax rates, in a bid to lure online businesses to their shores.

This kind of competition has always been present to some degree and large multinationals have always tried to play one country against another to obtain the best package of income tax holidays and other investment incentives before locating. In recent memory, Philippine and Thai investment agencies each tried to lure General Motors with more attractive investment incentive packages. General Motors eventually decided to locate in Thailand, though an important part of their decision had to do with Thailand's relatively more developed network of auto parts suppliers.

But the nature of electronic commerce is that the 'production facilities' are typically much more mobile. They may consist mainly of computers, a database (which would probably reside in the computer or a server anyway), and the server. So these kind of businesses are more likely to "vote with their feet" in deciding where to set up shop. The figure of "voting with their feet" was first coined and popularized by the economist Charles Tiebout in the public finance literature to refer to the possibility (maybe more theoretical than real) of Americans making choices of residence based on the tax and government services being offered by various geographical districts.

But as Tiebout originally argued and the Economist survey reminds us, tax competition may not be a bad thing. It forces governments to be more efficient in their provision of government services and it gives taxpayers a wider choice of what regimes they would prefer to be subject to.

The Economic Impact of Electronic Commerce

Forecasting technology or the rate of its adoption is always a risky process. New technology, when it does not flop, often goes through a period of rapid adoption followed by more mature growth rates. In other words, its growth path may be highly nonlinear initially and so projecting its growth (and impact on the economy) can be wide off the mark. Such is the case with electronic commerce. While it is not a major force for the Philippines at the moment, it is likely to grow in importance in the future.

One indisputable benefit of electronic commerce is that it could reduce transaction costs. For consumers or buyers this is most likely to take the form of lower search costs and better information on products and prices. For electronic or digital goods, there could be drastic savings in production and delivery costs as well.

¹⁸ "The Mystery of the Vanishing Taxpayer: A Survey of Globalization and Tax", *the Economist*, January 29, 2000.

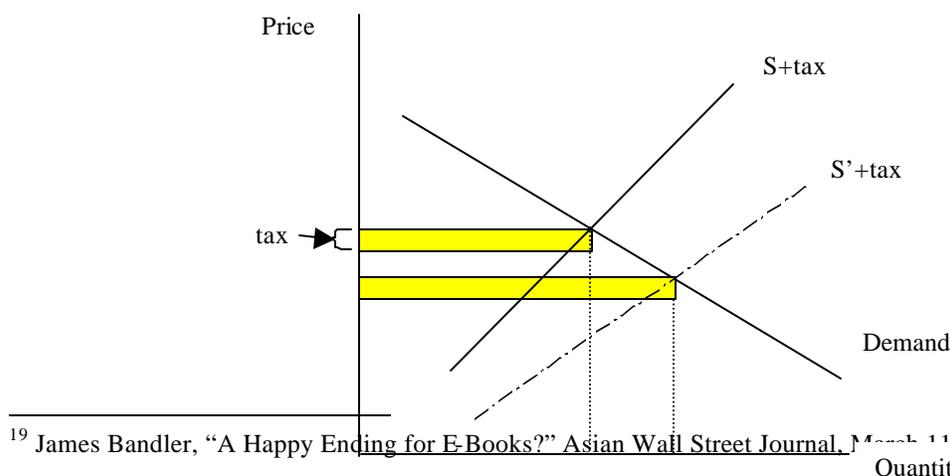
In terms of estimating the magnitudes, buyer search costs are very difficult to estimate. First, buyer search cost probably consists primarily of time spent searching or canvassing prices and products. Actual historical data on this probably does not exist as buyers probably do not keep time records on how much time they spend searching for information on goods and prices. Moreover, it does not have a corresponding explicit monetary expenditure, although one might be able to justify using the wage rate of the buyer concerned as a proxy for the opportunity cost of the person's time.

Furthermore, it is widely acknowledged that B2C is going to be smaller in magnitude than B2B. Especially in the Philippines, where PC and internet penetration is low, B2C transaction volume is not likely to be that great initially.

The effect of a cost saving to producers/suppliers is theoretically clearer. If the cost saving is approximately a per unit cost saving this could be modeled by a lower supply curve representing lower marginal costs of supplying the good. (see figure 5 below) This means that a greater quantity of the good will be bought and sold at a lower price. However, since the tax per unit stays the same, this redounds to an increase in tax revenue. (Bigger shaded rectangle in figure.)

The figure applies whether it is a reduction in the cost of producing and delivering a physical good or an intangible one. In the latter case however, the figure implicitly assumes that the demand for the good is unchanged. This may or may not be true of some intangible goods that were previously or could be delivered as physical goods; i.e. a digitized good like electronic books. In the case of electronic books for example, a survey conducted in the US suggested only 4% of internet users were "very likely" to buy an e-book and just 20% were "somewhat likely".¹⁹ Consumer preferences are probably slower to change in this case and even the availability of electronic devices that display electronic text may not immediately change many readers' preferences for the paper version of a book. This may not be the case for other goods like music.

Figure 5: Tax Incidence Part II



¹⁹ James Bandler, "A Happy Ending for E-Books?" *Asian Wall Street Journal*, March 11, 2002, p. T4.

There are several studies that have quantified the size of possible cost reductions due to electronic commerce and the application of information technology for some countries, mostly developed countries like the U.S., Canada, and Australia. Unfortunately, no similar study has yet been uncovered for the Philippines. Nevertheless, these studies do find that there could be significant cost savings associated with electronic commerce. For example, the Australian Tax Office cites a study which finds that in banking, transactions done via ATM and electronic fund transfer posting is only one third the cost of over the counter service involving human bank tellers. While this is not strictly electronic commerce as defined in this study (transactions over the internet), it should be comparable to the costs of internet transactions.

Revenue Canada in their report cites a 1996 study by Cyber Management Inc. that estimates electronic processing costs can range from one-fifth to as much as one-tenth the paper/human cost for the following common transactions²⁰:

Table 3: Cost Differences Between Paper and Electronic Processes

	<i>Paper/Human cost</i>	<i>Electronic Processing Cost</i>	<i>Savings Factor</i>
Producing and processing an invoice	\$100	\$10	10
Average retail banking transaction	\$1.50	\$0.15-0.25	6-10
Answering a customer request	\$15-25 (call center)	\$3-5 (internet self-service)	5
Mortgage application	1% of value	0.2% of value	5

Source: Revenue Canada, *Electronic Commerce and Canada's Tax Administration* (1998) p. 7

Lucking-Reiley and Spulber (2001)²¹ also cite other evidence of cost reduction: British Telecom estimated that costs fell from \$113 to \$8 per transaction when it moved its external procurement functions to electronic commerce. Master Card estimated its costs of processing purchase orders were cut from \$125 to \$40 with processing time shortened from 4 days to 1.25 days. Lehman Brothers estimated that a financial transaction costs \$1.27 when transacted through a teller but only \$0.27 through an ATM and \$0.01 for an on-line transaction!

It is always difficult to compare cross-country estimates, and cost savings for the Philippines may or may not be close to these estimates for admittedly first world countries. One might argue that because labor costs are lower in the Philippines, the cost savings of electronic versus manual transactions may not be as great.

Infrastructure deficiencies may also nullify supposed gains of electronic transactions. The experience of a procurement manager for First Philippine Holdings

²⁰ Minister of National Revenue's Advisory Committee, *Electronic Commerce and Canada's Tax Administration*, Revenue Canada, April 1998 p. 7.

²¹ David Lucking-Reiley and Daniel Spulber, "Business-to-Business Electronic Commerce", *Journal of Economic Perspectives*, vol. 15 no. 1, Winter 2001 p.57.

(which as part of the Lopez conglomerate is one of the founders and shareholders of the local B2B exchange Bayantrade) seems anticlimactic when compared with the estimates cited above. He commented that because transmission speeds were sometimes slow, electronic processing of a purchase order sometimes seemed to take as much time as the manual process. However this was based on casual observation rather than on a scientific study with careful measurements taken of processing time and costs. Nevertheless, he thought that if the operational problem of access speed were addressed, there is great potential for cost reductions from electronic processing.

Summary and Conclusions

These are just some of the issues involving taxation and electronic commerce. It could be argued that e-commerce for the most part will not require new tax principles. Existing principles still apply if only that old ways of doing things need to be digitized; e.g. electronic invoices/ receipts, filing of taxes etc. The support needed here may be to simply accord the same weight and importance as their old world counterparts had. The E-commerce Act has already provided for this.

However, the internet and e-commerce certainly does introduce some new business models and products that would not have been possible with old technology. And in some cases, new laws may be required or old laws amended. Trade in intangibles or goods that are in digital format promises to be the main problem area. These goods are easily moved electronically across the internet. This is likely to be an area where a multilateral approach is required. By its nature, the parties to such transactions are likely to come from disparate jurisdictions. Establishing tax situs in these cases may be problematic.

We must also keep things in perspective and remember that the amount of e-commerce transactions in the country is at present still small. There are obstacles having to do with infrastructure that limits the number of Filipinos who can shop online. Aside from there is also the low per capita income to hurdle. Of course, there is no reason though why Filipinos cannot sell goods and services over the web to nonresidents. Nevertheless, it should be safe to say that ecommerce is not likely to impact the economy in a huge way in the short term.

In any case, it is impossible to anticipate every possible loophole or leakage that can result from a new development. The history of tax collection is more often than not one of action-reaction. Authorities observe how taxpayers avoid taxes under the old laws and then create the remedy to close the loophole. This will likely continue to be the case.

We offer yet another angle to consider for now. This is to take an incremental view of the question. By this we mean to recognize that many of the problematic transactions from a tax perspective are transactions that would not have been possible, or certainly costlier in a world without the internet. That is, some of these transactions (especially those involving services) might not have occurred in the first place without

the internet. Thus, in a sense, there may not be incremental tax lost on those transactions. However, there is certainly lost *potential* tax revenue, if authorities could only monitor it. This is not to belittle the potential impact of e-commerce on taxation. There will unquestionably be some changes in the composition of the tax base (for example if people take to downloading electronic books, music and software rather than purchasing the physical counterparts).

Then also, the efficiency gains of employing electronic commerce (in logistics for example like wholesale and retail trade) would free up resources in the economy that could be applied elsewhere, thus increasing national output and theoretically, the tax base also. Thus it is possible that while there could be some tax losses at the start, the long run benefits will probably outweigh it.

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Annex 1

REVENUE MEMORANDUM ORDER NO. 21-2000

The following is a brief description of Revenue Memorandum Order No. 21-2000, as posted on the BIR website.

REVENUE MEMORANDUM ORDER NO. 21-2000 issued August 3, 2000 prescribes the policies and procedures in the processing and approval of taxpayer's Application for Permit to Adopt Computerized Accounting System (CAS) and its components. The components of a CAS covered by the Order are: 1) general journal, general ledger, and other subsidiary records; 2) sales, purchases, accounts receivable, accounts payable, inventory, payroll, ledgers and other accounting records; 3) generation of official accounting documents such as official receipts (OR), sales and cash invoices, cash vouchers, journal vouchers, billing statements, sales tickets, etc.; and 4) generation of reports as required by the BIR. A Computerized System Evaluation Team (CSET) shall be created for the National Office and Regional Office to conduct appropriate evaluation and recommend approval of the taxpayers' application to adopt CAS or its components. Evaluation shall be undertaken and completed within 30 days from receipt of the application and complete documentary requirements. Request for the approval of CAS shall be open to all taxpayers, whether classified as regular or large taxpayer. Taxpayer requesting approval for a Computerized Book of Accounts with computer-generated accounting records, whether the accounting system to be used is off-the-shelf or customized, need not apply for an authority to print (ATP) invoices and receipts. However, taxpayer requesting approval for a Computerized Book of Accounts without computer-generated accounting records shall need an ATP for their official receipts, invoices and the like. The permit to adopt CAS shall be deemed revoked whenever there are changes or modifications introduced into the approved CAS, or upon full consumption of the pre-approved range of serial numbers for the computer-generated official receipt or sales/cash invoice. Any such changes or modifications shall require a new permit. On the other hand, computer-generated accounting records with no pre-approved range of number of invoices and receipts prior to actual generation shall be reported to the Chief, Large Taxpayers Assistance Division, or the Chief, Excise Taxpayers Assistance Division or Revenue District Officer for proper recording and notation of the range of numbers of official receipts and invoices which have been consumed, as well as the range of numbers which have been cancelled during the immediately preceding taxable year within 30 days from the close of such taxable year. With the favorable recommendation of the CSET, the approval and signing of the permit to adopt CAS shall be the responsibility of the Assistant Commissioner of the Large Taxpayers Service or Excise Taxpayers Service for large taxpayers, and the Revenue District Officers for regular taxpayers.

Source: BIR, downloadable at http://www.bir.gov.ph/rmo_2000.html#rmo21-2000

Annex 2

Draft Revenue Regulation

(Only Section 2 Par. 2.3 reproduced here)

Exposure draft
Dec. 17, 2000

Republic of the Philippines
Department of Finance
BUREAU OF INTERNAL REVENUE
Quezon City

REVENUE REGULATIONS NO. ____

SUBJECT : Electronic Commerce Transactions
TO : All Internal Revenue Officers and Others Concerned.

SECTION 2. Electronic Commercial Activities.

2.3 Treatment Of Digitized Information Products For VAT Purposes. - Digitized information products shall be treated as intangible personal property right. Any payment to a non-resident of the Philippines as a consideration for any digitized information product such as, but not limited to, music, computer software, graphics programs, books, movies, or data bases which the said non-resident owner downloads to the personal computer of a resident of the Philippines, whether a VAT or a non-VAT registered person, for the latter's use shall be imposed with the creditable 10% VAT withholding, pursuant to the provision of Section 113 (C) of the Code, as follows:

"xxx Provided, further, That the payment for lease or use of properties or property rights to nonresident owners shall be subject to ten percent (10%) withholding tax at the time of payment. For this purpose, the payor or person in control of the payment shall be considered as the withholding agent.

"The value-added tax withheld under this Section shall be remitted within ten (10) days following the end of the month the withholding was made."

The digitized information product shall be treated as the intellectual property or property right of the aforesaid non-resident person. The aforementioned resident person shall, in turn, be treated as the lessee or licensee with respect to the lease or use of the said intellectual property or property right of the said non-resident who shall, accordingly, be considered as a withholding agent in respect of the 10% VAT due from the said non-resident. The aforesaid resident person shall, before making payment, withhold and remit the 10% VAT due thereon by filing a VAT return in his capacity as a withholding agent, for and in behalf of the said non-resident-payee.

(a) If VAT Withholding Agent Is A VAT Registered Person. - The

10%VAT so withheld and remitted to the BIR shall be treated as the said withholding agent's input tax which shall be available for credit against his output taxes.

(b) If VAT Withholding Agent Is A Non-VAT Registered Person. - The 10% VAT so withheld and remitted to the BIR shall be treated as the said withholding agent's cost or expenditure for income tax purposes: Provided, however, that whether or not he may be allowed to claim the same as deduction for income tax purposes shall depend on whether or not the corresponding requisites for its deductibility, under the income tax law and regulations, have been complied with.

Annex 3

ITECC LEGAL CLUSTER
BIR SUBCOMMITTEE

INITIAL PROGRESS REPORT

March 21, 2001
Makati City, Metro Manila

Introduction

The taxation issues brought about by electronic commerce are diverse as they are complex. On the international level, it is a balancing act between the right of a State to exercise its sovereign power over actors and activities within its jurisdiction and the right of individuals and companies to be free from double taxation and undue interference. On the local level, it involves the application of existing taxation regimes to newfangled business models and heretofore inexistent goods and services. Apart from identifying the proper tax statute to apply, the local tax authority faces the prospect of tax collection and administration in the new electronic environment.

The BIR Subcommittee aims to address some of the more pressing issues affecting the taxation of electronic commerce by providing assistance to the Bureau of Internal Revenue. Efforts are underway within the Bureau on several fronts and the Subcommittee is happy to report that the members of the Bureau's internal task force on electronic commerce have welcomed the participation and inputs of the ITECC Legal Cluster.

Challenges

In particular, the following are the challenges facing the BIR Subcommittee:

E-Taxation. As mentioned, the taxation of electronic commerce is a complex issue and one which does not lend itself easily to a resolution. Many of the problems and challenges are in fact beyond the Government's power to address and require the cooperation of the International Community. Nevertheless, the Subcommittee, in light of its recent coordination with the Bureau, have identified two (2) broad areas of concern.

Tax Situs Rules. The Tax Situs Rule mentioned in Section 23 of the Electronic Commerce Act has given rise to serious concerns. The Bureau feels that it is a license for parties to an e-commerce transaction to avoid paying taxes in the Philippines (or anywhere else for that matter) by mere agreement. The Bureau has already proposed the repeal of the relevant portion of the Electronic Commerce Act. The Subcommittee has already submitted its comment upon the amendatory bill.

The BIR has not yet submitted its proposal for the repeal or amendment of the relevant provision in the ECA although it has prepared a draft bill in this regard. Said draft bill is awaiting the signature of the BIR Commissioner and Secretary of Finance.

Application of Tax Code to Electronic Commerce. The Bureau is also faced with the spectre of applying the Tax Code to emerging business models, as well as new products and services. While the Bureau formulates its stand, electronic commerce companies are likewise concerned about their potential tax burden and responsibilities. The current regulatory gap impacts not only upon the planning process but may also determine the viability of a prospective business. Hence, it is imperative that the Bureau provide some clarity as to its position in order to promote stability and predictability.

Within the joint committee level (BIR taskforce and ITECC-LC BIR Subcomm), the BIR had reiterated its stand that no new taxes are being imposed on electronic transactions. However, the BIR has drafted proposed Revenue Regulation addressing the application VAT on digital or digitized products. Regardless

of this stand, the application of VAT and any form of taxation on electronic transactions shall result in negative reception by e-commerce players. It may also result into a negative perception in the international community. It is proposed that a moratorium on the application existing taxes or the imposition of new taxes be held in abeyance until such time that it can be determined that e-commerce in the country has reached a stable and profitable stage, or that a timeframe be identified for the moratorium to be in effect.

E-Retention. The Electronic Commerce Act allows persons to keep records in electronic form. In the context of the Tax Code, this means allowing taxpayers to keep their records, receipts and tax returns in electronic form. In addition, the Bureau must also consider the situation where taxpayers will maintain its records in both paper and electronic format. Finally, the Bureau must also address the issue of third party providers that taxpayers may engage to outsource their bookkeeping processes (ASP) or digitize their paper documents (digital imaging companies). RMO21-2000 dated July 17, 2000 addresses the processing of the applications to be filed by end-users to allow the use of Computerized Accounting Systems (CAS). RMO21-2000, through the use of CAS, allows the generation of underlying electronic accounting records (invoices, official receipts, journals, etc.) as well as the retention of such records. Said RMO also allows the conversion of existing paper based accounting records into electronic form. The mode of delivery of such records, in particular, invoices and official receipts, remains in paper form since the subject RMO provides for the "Authority to Print" said accounting records. Per meeting with the BIR, existing retention rules will still apply on electronic records, that is, 3-years or until such time that the BIR is able to complete its audit of the records. The following proposals has been put forward in one of the meetings between the BIR Task Force and the ITECC-LC BIR Subcom:

- a. to instead accredit commercially available accounting applications
- b. the rules or guidelines on the electronic delivery (that is no printing by seller will be required while buyer has the option to print) of underlying electronic accounting records be formulated.

E-Filing. The advent of the Internet in the Philippines coupled with the mandatory provisions of the Electronic Commerce Act are driving the Bureau's project to allow taxpayers to file their tax returns on-line. The project is slated for a dry run this tax season with more than 730 large taxpayers and 2000 voluntary Bureau employees. It has come to the Subcommittee's attention that the Bureau intends to accredit a certification authority (CA) as part of its project in order to assure the identity, integrity and non-repudiability of documents filed.

E-Invoices and E-ORs. A peculiar issue facing the Bureau, electronic invoices and official receipts (ORs) are vital in enabling a proper electronic audit of any taxpayer. The interaction between invoices inherent in the self-administering value added tax (VAT) must be preserved if the Bureau is to maximize the benefits of the new technologies.

Refer to comments on retention.

Other comments:

RMO-21-2000 defective provision. One of the documentary requirements for the application to use a Computerized Accounting System is a statement by the vendor that the said Computerized Accounting System is tamper-free. This may be extremely difficult, if not impossible to obtain since no vendor or software maker is willing to issue such statement.

Activities

Comments on Proposed Revenue Regulation on Electronic Commerce. The Subcommittee has already finalized its comments upon the proposed revenue regulations respecting electronic commerce. The formal transmittal of the comments will be undertaken through the ITECC.

Tax Situs. One of the more contentious issues respecting the proposed revenue regulation involves the tax situs rules included therein. The Subcommittee has taken the position that this has multi-jurisdictional dimensions and should not be addressed at this time.

From a policy standpoint, the regulation, if passed, may have deleterious effects upon efforts to make the Philippines an attractive site for investment and electronic commerce. If the Bureau will be intent on pursuing the passage of the regulations, the Subcommittee will petition the ITECC to take a similar stand in order to dissuade the Bureau from proceeding.

E-Retention. The Subcommittee will formulate and propose a comprehensive regulation respecting the retention of electronic tax records. Currently, research is being conducted as to approaches taken in other countries.

E-Filing. The Subcommittee is already coordinating with the Bureau personnel in charge of the project. We have been informed that rules and regulations are forthcoming and are awaiting its release for our review and comments.

Call for Support

The Subcommittee hereby calls for the support of all interested taxpayers to help in the work ahead. Currently, the Subcommittee is composed of a small but dedicated number of persons from the private sector. Representatives from a broader spectrum are subscribed to the Cluster mailing list (ecomm-irr) and the Subcommittee routinely posts updates of its work thereat.

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