

Consumption Tax on E-Commerce Transaction

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要 旨

近年急速に増大した電子商取引は、租税法の分野にも変革を迫っている。その一つが、国際的な電子商取引に対する消費税課税の問題である。従来の取引形態では商品を海外から輸入する際には商社などが通関時に消費税を支払い、買主への販売価格に上乘せする形で消費税が課税されていたが、消費者が電子商取引により海外から直接商品を購入した場合には、この仕組みが事実上機能しない。このことは、インターネット回線を使ってダウンロードする形で購入する場合に特に顕著である。その結果、現在、消費税が海外からの商品購入には課税されず、国内からの商品購入には課される状態になっており、課税の公平や中立の観点から問題である。本論文は、この問題への対処法について、欧州の付加価値税における Distant Selling (遠隔地販売制度) や米国の州間販売取引における Sales Tax (小売税) 制度等を参考に、考察したものである。

Keywords: Consumption Tax, E-commerce, Japan, EU, U.S.

I. Introduction

Nowadays, one can purchase goods and products without going to stores at the cheapest price through internet. For this reason, consumers using online shopping have dramatically increased. For example, Amazon.Com, an American book sales company is the biggest online retailer of books in the world at present.¹ In case of E-commerce, while it can expect the global market for potential customers, no brick and mortar stores for sales are necessary. Hence it can provide customers with inventories at much lower prices than those of traditional business by being more competitive with low operating costs.

On the other hand, current consumption tax of Japan is imposed only on domestic transactions and because of no physical presence or business bases in Japan, E-commerce business transactions of foreign

enterprises are not treated as domestic transactions of Japan. As a result, sales by E-commerce in Japan are exempted from Consumption Tax. This causes unfair competition to Japanese enterprises selling similar inventories in Japan, which are subject to 5 % of Consumption Tax, whose tax rate will soon be raised to 8% in 2014 and then 10 % in 2015.

In Europe, tax measurements to secure both fair competitions in Value Added Tax (VAT) and government revenue have already been introduced for E-commerce transactions such as “Distance Selling”. In the U.S., Streamlined Sales Tax Project for sales and use tax is introduced in many States in order to deal with distance sales.

In reference to the VAT measurements and the Reverse Charge Tax, this paper aims at proposing proper measurements that the Japanese government should introduce in order to cope with issues of E-commerce transactions by foreign enterprise. It includes exploration of new interpretation of the current Consumption Tax Act and then possibility of new legislation if the issue cannot be resolved by changing of law interpretation.

The research contains 6 parts. Part I is the introduction of this research paper, including a brief explanation of issues of current Japanese Consumption Tax with regard to sales by E-commerce. Part II explains about basic system of the current Japanese Consumption Tax Act and point out its problems in details. Part III is about the EU, VAT system which is to introduce a new system effective in 2015. Part IV describes the guideline provided by OECD. Part V discusses the U.S. sales tax system with its case laws and the amendment of definition of New York State Sales Tax in order to introduce “the Amazon Tax” and still in pending the “Marketplace Fairness Act”. Part VI analyzes, reviews the past researches, and followed by the conclusion.

II. Basic Structure of Japanese Consumption Tax

1. General

The consumption tax is one of indirect taxes imposed on goods and services, based on Consumption Tax Act (*Shohi Zei Ho*), together with Consumption Tax Enforcement Cabinet Order (*Shohi Zei Ho Sekorei*),² and Consumption Tax Ministry Order (*Shohi Zei Ho Sekokisoku*). According to the laws, all domestic transactions of individuals, corporations and import transactions are taxable when the annual sales amount exceeds threshold in the standard year.³ The tax is usually paid at each level of business during the

production and distribution process, and the total tax is finally to be borne by consumers since the paid tax is forwarded to the next stage of transactions. The tax rate is a single rate of 5%: total of 4% for national tax and 1% for a local tax. The tax is collected by the national government and then one percent is distributed to local governments.⁴

2. Transactions subject to consumption tax

Transactions subject to consumption tax are “(1) domestic transactions, (2) business activities, (3) transactions effected for compensation, and (4) transactions categorized as sales and leasing of assets or provision of services” within Japan.⁵

It is determined whether or not the transfer of property is made within Japan, as follows;

- (a) If the transaction is alienation or lease of assets, it is taxable when the assets are located in Japan.
 - (i) If the assets are ships or aircrafts used for international transportation, the transfer is regarded in a country where the institution for registration is located.⁶
 - (ii) If the assets are mining rights or quarry rights, the transfer is regarded to take place in a country where the mine or quarry is located.⁷
 - (iii) If the assets are intangible properties such as patents, the transfer is regarded to take place in a country where the institution for registration of intangible properties is located.⁸
 - (iv) If the assets are intangible properties such as copyrights, the transfer is regarded as taking place where the alien of assets is located.⁹
- (b) If a transaction is **the provision of services**, then it is taxable when the place the service is rendered is located in Japan.
 - (i) In case of international transportation service, if a departure place or a destination place is Japan, the transaction is regarded as taking place in Japan.¹⁰
 - (ii) In case of international communication service including international mailing service, if an origin place or a destination place is Japan, the transaction is regarded as taking place in Japan.¹¹
 - (iii) In case of insurance service, if the permanent establishment for concluding a contract of insurance is located in Japan, it is regarded as taking place in Japan.¹²
 - (iv) In case of furnishing information or design, if an office used for furnishing service is located in Japan, it is regarded as taking place in Japan.¹³

- (v) In case of providing services with special expertise for building capital assets such as buildings and plant, if most materials necessary for the building are procured in Japan, it is regarded as taking place in Japan.¹⁴

Locations of assignment or lease of goods are the main criteria to decide whether it has physically taken place in Japan at the time when transactions occur or services are rendered.¹⁵ Some transactions are excluded from taxation such as “transfer and leasing of land, transfer of securities and means of payment, money lending and other financial transactions, sales of postal and other stamps, medical services, and social welfare services” and so on.¹⁶ Export is excluded from consumption tax as they are to be taxed at the place where they are consumed.¹⁷

3. Taxpayers

Corporation and individuals are subject to consumption tax when transactions take place.¹⁸ According to Consumption Tax Act of Japan, taxpayers subject to consumption tax are (1) business enterprises who transfers a taxable asset within Japan¹⁹ and (2) a person who takes foreign taxable goods from bonded areas. However, small and medium enterprises whose annual turnover or revenue in the base period is less than ¥10 million are exempted from consumption tax. This threshold used to be ¥30 million prior to 2003.²⁰ A person whose annual turnover or revenue is under the threshold opts to be a taxable person to pay consumption tax by filing a document in a taxation office in charge of his/her jurisdiction so that he or she can get input tax credits.

4. Problems

According to the OECD report, under the pure definition of consumption, “tax should in principle accrue to the country in which the actual consumption takes place-for all transactions, whether business -to-business or business -to -consumer.”²¹

The current Japanese Consumption Tax Law provides that only domestic transactions are taxable by consumption tax. For example, when a Japanese consumer buys a product from domestic online retailers, the transaction is subject to consumption tax at 5%. On the other hand, when he purchases a similar product from foreign online retailers, consumption is exempted since it is considered as a transaction outside of Japan. As a consequence, it results in a disadvantage to Japanese online retailers as they have to charge 5% of

consumption tax while their foreign competitors can sell their products free of consumption tax, and hence the fairness and neutrality of tax is violated.

III. European Value Added Tax and its measurement for E-commerce transactions

1. Features of European VAT

The European Union (hereinafter referred to as the EU) established a new ‘**internal market**’ as a single market in 1992 with the aim of freeing movement of goods, service, and capital (initially created as “European Community”). This internal market is a fundamental for EU to accomplish “prosperity, growth, and employment.” The EU intends every EU member to take full advantage of this single market.²²

In the EU, VAT is a commonly adopted consumption tax imposed on commercial transactions of goods and services. The tax at each stage of production and distribution is shifted and finally born by consumers.²³ The basic rule of VAT is directed by EU in a form of VAT Directives which bind legislation of VAT in each EU member state.²⁴ The VAT rate of each member state can vary, but it must be in a range from 15% up to 25%²⁵ according to the VAT Directives.²⁶ The imported goods to the EU are generally subject to VAT at the time of goods entering into the EU for the fair competition in the European market.²⁷ The definitions of VAT provided by the EU are as follows;

- “A **general tax** that is applied, in principle, to all commercial activities involving the production and distribution of goods and the provision of services.
- A **consumption tax** because it is borne ultimately by the final consumer. It is not a charge on business.
- Charged as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain.
- Collected **fractionally**, via a system of partial payments whereby taxable persons (i.e., VAT-registered businesses) deduct, from the VAT they have collected, the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is **neutral** regardless of how many transactions are involved.
- Paid **to** the revenue authorities by the seller of the goods, who is a “taxable person”, but it is actually paid **by** the buyer as part of the price paid to the seller. It is thus an indirect tax.”²⁸

Taxable transactions include the supply of goods, intra-Community acquisitions of goods, supply of services,²⁹ and importation of goods. According to the current law, trades among member states have no barriers, so no tax is collected. For taxable persons with VAT registered, the input VAT is deductible if they can provide a VAT number of other state Members.³⁰

2. Intra-Community acquisition of goods

The place of taxation is the final destination of the Member State. Taxable person and non-taxable legal person is subject to VAT when they buy a good from another Member State. However, some Small and Medium size Enterprises (SME), or under the flat-rate scheme farmers and non-taxable legal person are exempted from VAT in case the annual purchase is under the turnover threshold set by their Member State. The rate is also applicable at the destination member state's tax rate. As provided "The acquisition of goods is taxed in the **Member State issuing the VAT number (Member State of identification)** under which the acquisition is made. Should the goods be **transported to another Member State (Member State of arrival)** tax must be paid there. This will be followed by an adjustment of the VAT paid in the Member State of registration."³¹ For example, in case of the Member State of identification,³² when a French company buys a good from another Member State by a French number, then the French VAT must be paid. Another example is when Slovakia purchase a good from Spain by providing the VAT registration number in Slovakia, then the tax should be paid at Slovakia.³³ For taxation in the Member State of arrival of the goods,³⁴ in case the good is bought by using a Slovakian VAT registration number, but in fact the good is sent from Spain to Germany, then VAT must be paid in Germany as acquisition and Slovakia tax due will be exempted respectively.³⁵

3. Supply of goods and services

According to the current law, a jurisdiction to tax **supply of goods** is at the place where a supplier is located.³⁶ On the other hand, a jurisdiction to tax **supply of services** is generally at the place where the supplier has his permanent establishment or if no permanent establishment exists, then at the place of his permanent address where he usually lives.³⁷ However, in 2010, a new rules of VAT package that "a place of supply of service is where the services are supplied" was introduced, thereby VAT on services is better accumulated to the country of consumption.³⁸ This rule concerns the nature of service supplied as well as the status of customer who receives service. A clear classification must be made between a taxable person or a non-taxable person (a final consumer).³⁹

B2B service

For business to business (B2B) service, “a customer’s place of establishment” should be regarded as a place of supply of service.⁴⁰ It means VAT due is in the country where the recipient of the services is established. As an example of B2B business, Polish company gave a legal service to a customer with a place of business in Sweden, but the service was given at the customer’s fixed establishment located in Finland. In this case, the service charge is subject to Finnish VAT according to the new rule.⁴¹

B2C service

On the other hand, for business to customer (B2C) service, VAT should be imposed at the place of ‘supplier’s place of establishment’.⁴² For an example of B2C business, A Greek supplier with a fixed establishment in Greece is to be taxed by Greek tax when he gives legal services to Romania customers for private purposes.⁴³

4. Electronically Supplied Services

Before that, the supply of services is taxable at the place of establishment of business unless the service is under the section of immovable property, or the service is such as entertainment, artistic, sport, financial service.⁴⁴ Obviously, when the supply is outside the EU and they provide services to the EU customers, then EU VAT is not applicable because the VAT on service is to be charged at the place of establishment.⁴⁵ Contrary to this, when EU supply service to non-EU, the EU suppliers are to be subject to VAT. This definitely makes EU disadvantage when selling digital products or online service to consumers outside the EU.⁴⁶ Therefore, it contradicts the principle of taxation from the viewpoint of fairness and competitive neutrality.⁴⁷

An online business like E-service is usually conducted in multiple countries and often it causes uncertainty in taxation regarding whether or not subject to the destination country tax. To deal with this problem, the EU has proposed to amend the regulation of VAT on E-commerce service in 2002⁴⁸ which ensure legal certainty to E-services business. The law was enforced in July, 2003 with the aim of eliminating the disadvantage for suppliers E-services in the EU. This amended regulation includes supply over the electronic networks for digital delivery, such as “software and computer services”. In addition, it also includes information and cultural, artistic, sporting, scientific, educational, entertainment or similar services. Accordingly, these services will be taxed at the place where the customer resides instead of the supplier’s

place. The purpose of the Directive is focused on “electronic services” or “electronically supplied services”. This change will erase the disadvantage faced by EU suppliers which will assure same VAT rules for non-EU supplier and EU suppliers when providing electronic services to the EU customers. EU suppliers no need to charge European VAT when they make a sale outside the EU⁴⁹ unless the service is effectively used and enjoyed in an EU country.⁵⁰

In case of (B2B) non-EU business supply to business in the EU with no VAT charged, VAT must be withheld by the customer (taxable person) under the reverse-charge mechanism (self-assessment).⁵¹ The commission has already set up a measurement of VAT information exchange system (VIES) network to provide real time confirmation of the VAT status. This system will provide the information to the traders to identify the status of their customers in case the customer is VAT –registered business or not, and help them to decide whether or not the tax should be charged.⁵²

As for (B2C) non-EU business supply to consumers in the EU as a mean of telecoms or broadcasting services, the VAT is charged at the place where service is being used and enjoyed in the EU.⁵³ A new change is applied in an electronic service to consumers in the EU, so the VAT must be charged where the consumer belongs.⁵⁴ The business is required to register for VAT purpose if they make a sale to final consumers in the EU. They are obliged to register in one of Member State and charge VAT rate of the state where the customer locates. The tax is due in every three months to be paid to the administration where they have registered for VAT purpose, together with the detail of total sales they made in each of EU Member State in the electronic return form.⁵⁵

However the rules for suppliers between EU countries remained the same. Service transactions within the EU will be taxed in the Member State where the customer belongs for B2B business. B2C business is taxed at the Member State where the supplier belongs.

It is expected that this new rule will have a great effect on U.S. based businesses as the U.S. is the exporter of digital products and services to consumers in the EU as well as to the rest of the world.⁵⁶

5. Taxpayers

The taxpayer is an individual person or an enterprise who carries out an “economic activity”.⁵⁷ Economic activity means any activity of supplying goods and services including mining and agricultural activities, and activities of the professions, exploitation of tangible or intangible property.⁵⁸ In addition, a person who carries out a business occasionally to vendors or customers outside the member state but within

the EU community, relating to the economic activity, should also be regarded as a taxable person.⁵⁹

The taxpayer is allowed to deduct their VAT by the amount they were taxed at the previous stage of transactions.⁶⁰ The VAT added to the goods and services is ultimately to be borne by the final consumer. The taxpayers pay VAT on behalf of the consumers to the national tax administration after the deduction of VAT they paid at the previous stage.⁶¹

6. Measurement to deal with E-Commerce as Distance selling

1. Distance Selling

The principle rule for distance selling is when a VAT-registered seller sells goods to customers in other Member States of EU who is not registered for VAT. According to distance selling rule, if the annual amount of sales to customers is below the threshold of the Member State of customers, then the seller applies the seller's state VAT tax rate.⁶² For an example, an Italy retailer sells handbag to French customers, under Italy VAT tax rate at 21% and French VAT tax rate at 19.6%.⁶³ If the retailer's annual sales to France are below threshold, the retailer charges 21% VAT from his French customers.

In case the annual sales amount exceeds annual threshold of customer's country, the seller must register as a non-resident VAT trader in a country of customers.⁶⁴ For an example, if an Italian retailer exceeds the sale of €100,000 to France, then the registration in France is required.⁶⁵ Then, the sale of Italian retailer is to be subject to French VAT at a tax rate of 19.6%, and the seller must pay the French VAT to French tax authorities using a French VAT return.⁶⁶

“Distance Selling” is applied only when goods are sold from Business in one of EU Members State to “a private individual” or a customer residing in another EU Member State who is not registered for VAT.⁶⁷ The aim of EU legislation is to put consumers using distance communication means and consumers using conventional face-to-face shops, in a similar position in terms of VAT throughout the EU.⁶⁸

Distance selling includes “catalogue sales, teleshopping, mobile phone commerce (m-commerce), and the use of the internet (E-commerce).”⁶⁹ However, some contracts are excluded such as “financial services, contracts by automatic vending machines or automated commercial premises, contracts with telecommunications operators through the use of public payphones, contracts for the construction, and sale of immovable property or relating to other immovable property rights except for rental, contracts at auction.”⁷⁰ Additionally, the directive does not cover the delivery of foods and drinks to the consumer's residence or workplace by regular rounds men. Furthermore, a contract to perform service on a specific date like

accommodation, transport, catering or leisure services is also excluded from the distance selling rule.⁷¹

Distance selling deals only with goods but not services. Moreover, it's effective only when an EU Member of VAT registered sells and delivers goods to a customer in another EU country who is not necessary to be registered and not registered.⁷²

7. VAT mini One Stop Shop

From 2015, for electronic service business like telecommunication services, television and radio broadcasting services and electronically supplied services from non-EU supplier (taxable person) providing service to a consumer in the EU who does not have a fixed establishment⁷³ as well as who has a fixed establishment, will always be taxable by VAT returns at the place where customers are located. They have to register for "VAT mini One Stop Shop" by which the supplier is exempted to register in each Member State in which he supplies services to his customers.⁷⁴ In other words, if a non-EU supplier registers in VAT mini One Stop Shop in one of the EU member countries of their choice, then they do not need to register in every country like previously. This mini One Stop Shop scheme is optional for taxable persons. The taxable person can register in every country as previously if he so prefers.

The VAT due and tax return is to be submitted quarterly to the tax office electronically, and then the information will be transmitted to the Member State. After that, the tax office will allocate and share the VAT payment to a corresponding country at the national rate charged.⁷⁵

Whether this system is effective or not, it will be enforced in 2015 onwards. The importing VAT tax on the electronic service is the first time to be introduced in the EU.

IV. Guideline by OECD

According to the draft detailed guideline of the OECD Subgroup on Electronic Commerce, there is a guideline on the definition of the place of consumption and recommended approaches to the practical application. The main purpose of this guideline is:

1. "To prevent double taxation, or unintentional non-taxation, rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where the consumption takes place.

2. For the purpose of consumption taxes, the supply of digitized products should not be treated as a supply of goods.

Where businesses acquire services and intangible property from a non-resident vendor, consideration should be given to the use of reverse charge⁷⁶self assessment or other equivalent mechanism.”⁷⁷

B2B transactions

For cross-border supplies of services and intangible property which delivery from “remote location” to a non-resident business recipient should be regarded “the jurisdiction in which the recipient has located its business presence.”⁷⁸ However, in some situation, different criterion should decide where should be the place of consumption.⁷⁹

B2C transactions

The place of consumption for B2C business is defined as “should be the jurisdiction in which the recipient has their usual residence.”⁸⁰ Anyhow, application of this guideline is limited to the cross-border supply of services and intangible property only to the transaction which delivered from a remote location. This guideline excludes the service which is unable to directly deliver from a remote location, for an example hotel accommodation, transportation or vehicle rental.⁸¹

Practical Approaches

There are three tax collection mechanism introduced to collect consumption tax, which is “registration, reverse charge/ self-assessment, and collection of tax by customs authorities on importation of tangible goods.”⁸²

B2B transactions

For cross-border B2B business, it's suggested that “in cases where the supplying business is not registered and is not required to be registered for consumption tax in the country of the recipient business, a self-assessment or reverse charge mechanism should be applied where this type of mechanism is consistent with the overall design of the national consumption tax system.”⁸³

B2C transactions

For B2C business, the member countries admit that there is no single option and further exploration of this issue is necessary for better outcomes. Meanwhile, a registration system seem should be recognized in order to collect tax on B2C transactions.

In case when the country think the registration system is appropriate to apply to the non-resident vendors of services and intangible property which is not currently registered and not necessary to be registered for that country tax, there is an important factors to be considered. It includes “the effective and efficient collections of tax, simplified registration requirements for non-residents suppliers, apply registration thresholds in a non-discriminatory manner, and enforcement measures to ensure compliance.”⁸⁴

V. US Sales Tax for E-commerce transactions

1. Basic Structure of US Sales Tax

General

According to the definition of general sales tax provided by Internal Revenue Code of U.S, “General sales tax means a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items.”⁸⁵ No general sales tax exists at a federal level in the U.S. Instead, each State or local government has a complete power to decide which goods and services are to be subject to sales and use tax.⁸⁶ Therefore the definition of retail sales and services subject to sales tax varies by State, which causes many problems for a taxpayer who operates business in more than one State. Not all types of goods and services are subject to sales tax. Most states exempt from the tax some kinds of business such as food, clothing, medical suppliers, and motor vehicles.⁸⁷ Although the tax incidence is on consumers, the seller is basically required to collect Sales tax and pay it on behalf of consumers.⁸⁸ Sales tax is applicable only to retail sales, not for re-sale. The applicable sales tax rate varies from state to state.⁸⁹

The requirement to collect the sales tax is only on transactions within a state unless there is a minimum connection or ‘nexus’ with the other state.⁹⁰ For nexus to exist, physical presence like a place of business must be established and maintained such as an office, employees, and individuals or an agent providing service.⁹¹ Almost all States levy the sales tax except Alaska, Delaware, Montana, New Hampshire, and Oregon. Even these five States charge specific sales taxes on certain products and services.⁹² At present, online retailers conducting E-commerce business are obliged to collect the sales tax from the sales in a state

of retailer's location.⁹³

In 2008, New York State amended the tax law and expanded the definition of physical presence as a 'vendor' for the purpose of local sales tax within the State. In the New York State Law, "every vendor of tangible personal properties" is required to collect the sales and use taxes on the sales of tangible personal property made to the New York State residents.⁹⁴ A "vendor" is defined as "a person who solicits business" within the State by using affiliates, agents or other representatives.⁹⁵ The vendors need to register at the Department of Taxation and Finance (DTF) and then the certificate is granted to permit them to collect the sales tax.⁹⁶ According to this amendment, presumption is given that if a "vendor" made a contract with affiliates in New York to solicit business within the State, it can be presumed that the vendor has physical presence, and therefore New York State can command to collect the sales tax.⁹⁷

This amendment is reflection of reality that in fact there are many sales of goods to New York residents through the internet. There are two conditions for the amendment:

1. An out-of state seller was "Soliciting business [in New York] through an independent contractor or other representatives if the seller enters into an agreement with a resident of this State under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller,
2. If the cumulative gross receipts from sales by the seller to customers in the State who are referred to the seller by all residents with this type of an agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods ending on the last day of February, May, August, and November."⁹⁸

By this amendment, out-of-state sellers become responsible to collect sales or use taxes when they have a contract with an in-state resident to solicit business through the internet or website with New York residents.⁹⁹ However, the law also provides that the presumption can be denied if the seller can prove that the resident "did not engage in any solicitation in the State on behalf of the seller that would satisfy the nexus requirement of the United States Constitution during the four quarterly periods in question."¹⁰⁰

2. Case Law in Sales tax

Quill Corp v. North Dakota

While the internet has expanded over the years, this Quill case¹⁰¹ has been a controlling case regardless of technology improved.¹⁰² As explained above, in the U.S. the sales tax is imposed on transactions that take place within a state. The U.S. Supreme Court held in many cases that physical presence or nexus is necessary in order to tax sales tax of other states.¹⁰³ In 1992, the Supreme Court held a case of Quill Corp v. North Dakota¹⁰⁴ in which the state cannot impose sales tax on out-of-state transactions without physical presence.

The Quill Corporation of Delaware sold an office supplier in North Dakota State where they had no office and no employees were hired. The business was to send catalogs to customers and take orders by telephone. North Dakota filed a lawsuit to Quill Corp to pay the sales tax on the transactions made to their residents. However, Quill denied to pay the tax and appealed to a higher court and the ruling was favored to the Quill with the reason that Quill had no physical presence in the State and therefore the sales tax should not be collected.¹⁰⁵

New York Amazon Tax

Amazon¹⁰⁶, the biggest E-commerce in the U.S. has taken full advantage of physical presence by avoiding the sales tax while having business in all the fifty States of U.S. By using 'entity isolation' which setting the subsidiaries to function business like order taking, research and development on behalf of them on the contract basis. As a subsidiary is a legally separated entity, there is no way to impose sales tax on Amazon in this case.¹⁰⁷ Obviously the subsidiary benefits public service from N.Y. State but Amazon alleged that they should not be enforced to pay the sales tax because it doesn't directly benefit the public service from N.Y. State. The State argued that Amazon should be subject to the sales tax because without the help of the subsidiary to fulfill the customer's order, their business would not function that well.¹⁰⁸

Soon after the New York amendment became effective, Amazon filed a lawsuit against New York State. In the remarkable Amazon vs. New York¹⁰⁹ case, the plaintiff was Amazon.Com that situates in Delaware State and has no office, employees or any kind of properties in New York. The sale is made through internet to New York residents and the products are directly sent to customers from outside of New York. Amazon offered facial challenge to the statute as unconstitutional by raising three issues on the statute. Firstly, they argued that the statute was against the Commerce Clause of the Constitution by lacking "substantial

nexus” within the state. Secondly, Amazon stated that the statute violates the Due Process of Law because the presumption is vague, ridiculous, and ineffective. Thirdly, it argued that the statute breached the Equal Protection Clause of the Constitution because this statute is mainly targeted to Amazon which is the world’s biggest internet retailer. Nevertheless, the Supreme Court of New York dismissed the claim and declared that the statute is constitutional on its face, and it doesn’t violate the Equal Protection Clause as well as the Commerce and Due Process Clauses and therefore affirmed that Amazon should pay the sales tax to the State.¹¹⁰ As of now, Amazon has collected sales taxes in 19 states and remits them to relevant states.¹¹¹

Performance Marketing Association, Inc. v. Hamer

In 2011, Illinois enacted “Amazon Law” or “Click-through Nexus Law”¹¹² which requires out-of-state retailers to collect the sales tax and the use tax when they engage in “performance marketing” with certain in-state persons for a commission or others.¹¹³ The law is similar to “New York Amazon Tax Law”. “Performance marketing” is that retailers pay for advertisements when sales is made. For example, in case of internet advertisements, an out-of- state retailer requests local website administrators to put a link on their websites for advertisement. If a consumer clicks on the link and the sale is made through this link, the local website administrator will get paid. The threshold under click-through nexus statute is over \$10,000 sales per year.¹¹⁴

The case of Performance Marketing Association, Inc. v. Hamer¹¹⁵ was that the plaintiff brought a lawsuit against the representative for Illinois Department of Revenue to challenge the Click-through Nexus Law, commonly known as “Amazon Tax”. The Illinois Circuit Court held that the Illinois Act which includes “Click-through Nexus Provision” violated the Commerce Clause of the U.S. Constitution and was preempted by the Internet Tax Freedom Act (ITFA)¹¹⁶ which bans “multiple discriminatory taxes on electronic commerce”. Then Illinois appealed the case to the Supreme Court of Illinois.

The Supreme Court of Illinois also affirmed in favor of the taxpayer. In rendering this case, the Supreme Court of Illinois viewed that “performance marketing” is not only limited to internet marketing but it also exists in print media which is not subject to the tax under the Illinois statute. In addition, the Supreme Court of Illinois also referred to the Internet Tax Freedom Act (ITFA) and found that the Click –through Nexus Law discriminated electronic commerce against the ITFA, and therefore it is invalid. The court did not reach the issue of the Commerce Clause of the Constitution.¹¹⁷

Until now, the concept of ‘nexus’ has been used on the E-commerce transaction, which prevents the state to tax the transaction made to the other states. Due to the huge annual budgetary deficit of over \$1 trillion¹¹⁸ together with the debts exceeding \$10 trillion,¹¹⁹ taxing E-commerce transactions across the state becomes fascinating to the government. As a consequence, Amazon, the world biggest online firm, becomes a target of the U.S. governments to tax them properly. It is a hot issue at present whether or not the U.S. state governments should introduce a new law similar to the EU distance selling system.¹²⁰ Current law definitely creates unfair competition with out-state retailers free of the sales tax, while sales by E-commerce by in-state retailers are subject to the sales tax while out-of-state are.¹²¹

3. Marketplace Fairness Act 2013

In 2013, the Marketplace Fairness Act passed the Senate. The legislation is still pending under House of Representative as of end of 2013. The Marketplace Fairness Act allows the states to collect sales and use taxes on “remote sellers” which includes online and catalog retailers when transactions are made, regardless of physical presence in the state or not.¹²² However, the Marketplace Fairness Act requires some simplification of sales tax law. First, the state requires to join the Streamlined Sales and Use Tax Agreement (SSUTA).¹²³ “This SSUTA Agreement is a result of the joint efforts of 44 states, the District of Columbia, local governments and the business community to simplify sales and use tax collection and administration by retailers and states. The Agreement minimizes costs and administrative burdens on retailers that collect sales tax, particularly for retailers operating in multiple states. It encourages "remote sellers" selling over the Internet and by mail order to collect tax on sales to customers living in the Streamlined states. “It levels the playing field so that local "brick-and-mortar" stores and remote sellers can operate under the same rules. This Agreement ensures that all retailers can conduct their business in a fair and competitive environment.”¹²⁴

Second, alternatively for non-member states, states must implement the minimum simplification requirements.¹²⁵ In this case, the state must agree to some application:

- “Notify retailers in advance of any rate changes within the state
- Designate a single state organization to handle sales tax registrations, filings, and audits
- Establish a uniform sales tax base for use throughout the state

- Use destination sourcing to determine sales tax rates for out-of-state purchases (for example, a purchase made by a consumer in California from a retailer in Ohio is taxed at the California rate, and the sales tax collected is remitted to California to fund projects and services there)
- Provide **free software** for managing sales tax compliance, and hold retailers harmless for any errors that result from relying on state-provided systems and data”¹²⁶

The states hope the measure on this provision will make it easier for them to collect the sales tax across the country. As of today, the retail world is very distinct, the controlling Quill case is no longer applicable to the sales tax. It is believed that the Marketplace Fairness Act will be a big help in collecting sales tax and use tax.¹²⁷

VI. Past Research

A basic proposal made by Professor Scott¹²⁸ has 10 characteristics:

- 1) **Share Tax Base.** Consumption Tax should be shared by both the origin country and the destination country. To ensure that, the consumption tax should be collected and paid to the origin country by giving interest to the collecting country.
- 2) **Registration System for Business, Government, and Charities.** To avoid accumulation of consumption tax, business should be registered in a country where it has active business through one or more physical establishment. Those sales made to registered business should be exempt from the consumption tax. Sales to governments and charities should be exempted from consumption tax.
- 3) **Universal product Coding System.** To determine what products are taxable or not and taxable rate.
- 4) **Third Party Collection and Payment.** Credit card companies or banking institutions should function to administer the system by receiving fees.
- 5) **Universal Software to Determine taxability.** To determine the tax due on each sale by both third parties and sellers.
- 6) **Audit Insurance.** Sellers are free from being audited as long as sold within the system.
- 7) **Audit Function.** Primary audit is to be in the destination country.
- 8) **Privacy.** As many countries are involved, the use of privacy of businesses and consumers should be restricted.

9) **Adoption.** Universal adoption is necessary. The rule should be applied by state-to-state, country-to-country.

10) **Income Redistribution.** Higher share to the lower income country to promote public health, public education an infrastructure improvement.¹²⁹

Another proposal was made by Emily¹³⁰ “to enact federal legislation that is much narrower in scope than “the Streamlined Sales and Use Tax Agreement (SSUTA)”, focusing solely on a state’s ability to collect sales tax from remote vendors.”¹³¹ In addition, “the proposal of federal legislation should be similar to New York’s Amazon Law. It would create an affiliate nexus definition of physical presence, but would not go to extreme lengths to entirely change and attempt to simplify state sales tax definitions and rates.”¹³²

Review

In case of international E-commerce transactions of tangible goods, consumption tax should be imposed at the time the goods pass custom office, same as today, in an island country like Japan, different from transactions among EU member countries or among US States where custom offices are not involved in the transactions.

In fact, when the transactions are made from a foreign business party directly to domestic consumers such as Amazon.Com, collecting consumption tax at custom office seems difficult to administer as prescribed by the law even now because of the big volume of entire transactions and small values of prices each unit.

Besides, under the recent trade policy of Japanese government to conclude bilateral or regional Free Trade Agreements, it will be more difficult to keep such administration for collecting consumption tax in order to realize competitive parity between domestic business parties and foreign business parties for years to come.

Hence some device must be introduced as early as possible to recover fairness and neutrality of taxation between foreign businesses subject to de-facto no consumption tax and domestic business subject to consumption tax.

International E-commerce transactions of intangible properties which can be downloaded through internet or telephone line are not taxable by consumption, even under the current Consumption Tax Act by being defined that those transactions take place in a country where a supplier resides. In order to realize

completion parity between domestic business and foreign business, if the Consumption Tax Act should be amended to make the e-commerce transactions taxable by defining them as taking place in a country where consumers are located. Then an implementation issue arises: that is, how to administer the new act under the situation where the Japanese government has no way to grasp the transaction records of foreign business parties.

There are three choices of methods conceivable in reference to the foreign country's system.

First method proposed is to enforce foreign business parties whose annual transaction amounts exceed threshold to register and pay consumption tax in the same manner as domestic business parties. A question is how the Japanese government can confirm whether the transaction records reported by foreign business parties are true and trustable. To fully use the exchange of information clause under tax treaties is one way to deal with this issue.

Second method proposed is to enforce buyers, including consumers to declare annual total transaction amounts they purchased through international e-commerce transactions and pay the consumption tax to the Japanese government if it exceeds certain threshold amounts, such as the reverse charge system in EU and the use tax system in the US. The issue here is how to achieve compliance of buyers. If a buyer is a domestic business party, a certain level of compliance can be expected because it is subject to frequent tax audits for corporation tax and proper tax treatment of consumption tax is also examined at the same time. The domestic business buyer can shift the consumption tax incidence to consumers so that they don't have to bear the tax anyway.

Compared with business parties, it is hard to expect that consumers declare their purchase amounts from foreign business parties through internet for consumption tax and pay it to Japanese government because they are less likely to be audited.

Third method proposed is for Japanese government to conclude tax treaties for mutual assistance of consumption tax collection with possible sellers' countries by e-commerce, by which a treaty contracting state shall charge consumption tax on behalf of Japanese government based on reciprocal base as well as providing transactional record information in a form of automatic exchange of information. The point of this method is that when a seller fails to pay due consumption tax to the Japanese government, the treaty partner country government will collect taxes on behalf of Japanese government. If a kind of multi tax treaty for consumption tax is created and a consumption tax collection network is created, that is the best solution but the probability of realization is not necessarily high.

In either of the above methods, certain numbering systems for identifying taxpayers and buyers are essential, otherwise it is impossible to manage huge volume of transaction records to be processed electronically in a computer. Different from EU member countries with VAT registration numbers and the U.S. with Social Security Number for individuals and Employer Identification Numbers for companies, Japanese taxpayer numbering system (My Number System) has just introduced. It may take some time for the new numbering system to be accepted and common by all the Japanese taxpayers.

Based on the above consideration, I agree with EU VAT mini One Stop Shop for B2C transaction that the place of consumption should be taxed at the place where consumed, so that it becomes taxable in the consumed country. The registration requirement above the threshold for VAT should be provided by law. Since Japan has only one tax rate, the application should be simpler. For offline E-commerce, it's easier to track or collect consumption tax at customs when the time of importation. For online transaction such as downloading music and software, there is no way to track or very difficult. The registration system is a good choice for B2C transaction. By identifying the registration number, sellers can easily declare the consumption tax to a State of customers.

For B2B transaction, the reverse charge/self assessment should be introduced as suggested in the OECD's guidelines. Thus, buyers can declare and pay the consumption tax to their government because they are familiar with tax payment through business activities.

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