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IMPLICATIONS OF SINGAPORE'S INCOME AND CONSUMPTION TAX POLICIES ON INTERNATIONAL E-COMMERCE TRANSACTIONS OF DIGITIZED PRODUCTS

Neal Harold Luna

Abstract: The Internet's current architecture allows international e-commerce transactions of digitized goods to go untaxed by the country in which the income was earned or the product consumed. The inability of these countries to tax such transactions will erode their tax bases as e-commerce in digitized products grows relative to other commercial forms. To forestall the erosion of its tax base, Singapore's revenue authority boldly extends its existing consumption and income tax policies to e-commerce. Singapore's proposed e-commerce tax regime is a model from which other countries—both those with similar tax regimes, such as the E.U. member economies, and those that trade with them, like the United States—may learn. While Singapore's e-commerce tax policy provides guidance and strives to promote internationally accepted tax principles, it also raises concerns of exposing e-vendors of digitized products to double-taxation, overly burdensome compliance costs, and unequal tax treatment, both between small- to medium-sized e-vendors and their larger competitors, and between e-vendors and brick-and-mortar entities. The Singapore government should clarify that domestic consumption of digitized products purchased from foreign e-vendors will be taxed; conclude a bilateral tax treaty with the United States government to alleviate double-taxation concerns; adopt a standard to clarify which transactions will give rise to ordinary income and which to royalty income; monitor the economic consequences of the consumption tax registration threshold, the policy to base consumption tax jurisdiction on where the customer purports to reside or on the customer's domain name or IP address, and the requirements on e-vendors to obtain residency declarations from its customers and collect and remit the consumption tax; and share its e-commerce tax ideas and experiences with the international community, in particular the OECD member states, to negotiate e-commerce tax protocols that strengthen its e-commerce tax regime.

I. INTRODUCTION

MusicNow.com is a fictional U.S. vendor that sells digitized music via its website.[1] For a nominal fee, the company also provides a music-finding service that customers can utilize to locate albums and CDs that other customers are willing to sell. Suppose John, a Singapore resident, wishes to purchase and download B.B. King's "Live At The Regal" album in digitized form and utilize the music-finding service to locate a CD of Charlie Parker's 1949 Christmas performance at Carnegie Hall. This simple transaction raises complex international tax issues under the current

[1] MusicNow.com is an example of an e-vendor (i.e., a vendor that sells its products online via a website).

architecture of the Internet. Which country may tax which part of this transaction? Must MusicNow.com pay Singapore income tax in addition to U.S. income tax? Does the price that John pays include Singapore sales tax?

The answers seem elementary, using international tax concepts that developed in the spirit of world trade and cooperation after World War I.[2] These rules, as evolved over the years, are embodied in many nations' bilateral tax treaties and in the model tax treaties of international organizations, such as the Organization for Economic Cooperation and Development ("OECD") and the United Nations ("UN"). They dictate which state may tax which part of the transaction: the one in which a trader resides (i.e., the exporting, or "resident" state) or the one from which a trader earns the income (i.e., the importing, or "source" state).

Generally, in the bricks and mortar[3] commercial world outside the context of electronic-commerce ("e-commerce")[4] and transactions involving goods and services in digital form ("digitized products"), the country where the transaction is deemed to have taken place is the country that has the power or jurisdiction to tax the transaction.[5] In the example above, if MusicNow.com had salespersons, a branch, a distribution depot, or some other fixed or "permanent establishment" in Singapore, the transaction would be deemed to have taken place there. Singapore, rather than the United States, would have the power to levy income and sales taxes on John's purchase of the B.B. King CD and utilization of the music-finding service.[6] However, these principles are not as easily applied to e-commerce transactions involving digitized products.

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[2] Arthur J. Cockfield, *Balancing National Interests in the Taxation of Electronic Commerce Business Profits*, 74 TUL. L. REV. 133, 135 (1999).

[3] "Bricks and mortar" refers to commercial entities with a physical (non-Internet) presence. TECHENCYCLOPEDIA, *at* http://www.techweb.com/encyclopedia/defineterm?term=bricks+and+mortar.

[4] For a definition of e-commerce, see *infra* notes 26-28 and accompanying text.

[5] Stephen J. Kobrin, *Taxing Internet Transactions*, 21 U. PA. J. INT'L ECON. L. 666, 670 (2000).

[6] INLAND REVENUE AUTHORITY OF SINGAPORE, INCOME TAX GUIDE ON E-COMMERCE para. 8.1.3 (3d ed. 2001), http://www._iras.gov.sg/Ec/Ec_frame.htm (Feb. 23, 2001) [hereinafter INCOME TAX GUIDE]; INLAND REVENUE AUTHORITY OF SINGAPORE, GOODS AND SERVICES TAX GUIDE ON E-COMMERCE para. 3.1.3 (2d ed. 2000), http://www.iras.gov.sg/Ec/Ec_frame.htm (Aug. 31, 2000) [hereinafter GST GUIDE]. *See generally* Cockfield, *supra* note 2, at 135.

This Comment describes how Singapore's tax authority (the Inland Revenue Authority of Singapore or "IRAS") purports to tax the income and consumption derived from e-commerce transactions of digitized goods and services,[7] and analyzes this policy through the lens of internationally negotiated tax principles and recommendations. This Comment further highlights the regulatory tax regime that U.S. e-vendors of digitized products currently face in their activities with Singapore customers. Most e-vendors of digitized goods and services reside in the United States,[8] accounting for as much as eighty percent of all global e-commerce sales.[9] Important lessons that would benefit U.S. e-vendors as well as other economies with similar tax regimes can be learned from analyzing Singapore's attempt to apply existing international income and consumption taxes to e-commerce transactions involving digitized products. While Singapore's e-commerce tax policy provides guidance and strives to promote internationally accepted tax principles, it also raises concerns of exposing e-vendors of digitized products to double-taxation,[10] overly burdensome compliance costs, and unequal tax treatment between small- to medium-sized e-vendors and their larger competitors, as well as between e-vendors and brick-and-mortar entities.

Part II provides general background information on Singapore's e-commerce environment, the difficulty of taxing e-commerce transactions of digitized products, and the popular arguments for and against taxing Internet transactions. Part III presents the OECD's broad principles of international taxation and current recommendations for the income and consumption tax treatment of e-commerce transactions of digitized products. These will be the analytical tools used to examine Singapore's income and consumption tax policies on international e-commerce transactions of digitized products. Part IV describes Singapore's current consumption and income tax regimes and how they are applied to e-commerce. Finally, Part V applies the OECD principles and recommendations to the way that Singapore taxes income and consumption from international trade in digitized products to reveal the benefits and weaknesses of Singapore's e-commerce tax regime, and to suggest ways to strengthen it. If Singapore's e-commerce tax regime is able

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[7] Digitized goods and services are also known as "intangible" goods and services. Ned Maguire, *Taxation of E-Commerce*, 47-JUN FED. LAW. 24, 25 (2000).

[8] Clayton W. Chan, *Taxation of Global E-Commerce on the Internet: The Underlying Issues and Proposed Plans*, 9 MINN. J. GLOBAL TRADE 233, 238 (2000) (citing Kimberly Strassel, *Internet's Relative Economic Impact is Played Down in Report by OECD*, WALL ST. J. EUR., Sept. 28, 1998, at B9H).

[9] *Id.*

[10] International double-taxation occurs, for example, when a company, residing in country A, sells a product to a resident of country B and is taxed by both countries on the same income. *See infra* Part II.A.

to produce the right amount of tax at the right time effectively, efficiently, and fairly, it can serve as a model for other countries, especially for those that rely heavily on consumption tax revenue, such as European Union ("E.U.") economies.[11]

II. BACKGROUND

A. *Singapore's E-Commerce Tax Regime Holds Significant International Implications.*

It is appropriate to focus on Singapore because it is in a region expected to experience tremendous growth in e-commerce in the near future. One study predicts that by 2004, twenty-seven percent of active Internet uses will be in the Asia-Pacific region and both business-to-business ("B2B") and business-to-consumer ("B2C") e-commerce will increase ten-fold to over U.S.$300 million.[12]

Within this dynamic commercial context, Singapore is making a concerted effort to provide an environment in which e-commerce will continue to flourish by providing a clear and fair regulatory regime.[13] The country favors a more proactive approach to regulating e-commerce, in contrast to the United States' current laissez-faire approach to e-commerce regulation.[14] Also, the IRAS has published detailed, easy-to-understand guides on how income and consumption derived from e-commerce will be

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[11] Chan, *supra* note 8, at 251 (citing Jennifer L. Schenker, *Why E-Commerce and the Euro Will Pack a Punch: Tax-free Days in Cyberspace Could be Numbered*, WALL ST. J. EUR., Sept. 7, 1998).

[12] Steven Schwankert, *eMarketer: 27 Percent of World's Net Users in Asia by 2004*, ASIA.INTERNET.COM (Feb. 7, 2001), *at* http://asia.internet.com/cyberatlas/2001/0207-emarketer.html.

[13] Clement Teo, *Singapore Pushes for Internet Economy: Government Calls for a Trusted Global Hub*, ASIA COMPUTER WKLY., Aug. 14, 2000, *available at* 2000 WL 15011295; Jorina Choy, *Singapore/Malaysia: Singapore Seeks Global 'Infocomm' Role*, ASIA COMPUTER WKLY., Jan. 24, 2000, 2000 WL 15010887; *Singapore Focus: A Blueprint for an E-Commerce Hub in Asia*, ASIA COMPUTER WKLY., Sept. 13, 1999, 1999 WL 18294368.

[14] For example, the U.S. government has imposed a temporary moratorium on taxing e-commerce and has passed a technology-neutral federal electronic signature law that addresses only the statute of frauds issue regarding electronic signatures. Electronic Signatures in Global and National Commerce Act, Pub. L. No. 106-229, 114 Stat. 464 (to be codified at 15 U.S.C. §§ 7001-7031). *See also* Nancy L. Perkins, *New Electronic Signature Legislation Validates Online Contracting*, 17(12) COMPUTER & INTERNET L. 1 (2000) (stating that "the fundamental purpose of the new law is to establish that a signature, contract, or record relating to a transaction involving interstate or foreign commerce may not be denied legal effect or enforceability simply because it is in electronic form). In contrast, Singapore's Electronic Transactions Act goes beyond the statute of frauds issue and allocates risk and liability for parties to documents that are signed electronically. Electronic Transactions Act ch. 88 (1998) (Sing.), http://www.lawnet.com.sg/freeaccess/ETA.htm (last visited Apr. 20, 2001). *See also* Info-Communications Development Authority of Singapore, *Legal and Policy Environment*, *at* http://www.ec.gov.sg/policy.html#tax (last visited Apr. 20, 2001).

taxed.[15] Whereas China has yet to determine how it will tax e-commerce transactions,[16] and Japan supports the U.S. position of keeping the Internet tax-free for now,[17] Singapore hopes to become an Asian e-commerce hub by providing a clear and fair regulatory environment.[18] As such, it is one of the few economies (if not the only) to explicitly state how it intends to tax e-commerce consumption and business income from e-commerce transactions.

Furthermore, Singapore's experience with its income and consumption taxes on international e-commerce transactions may serve as a case study for other countries with similar tax regimes. Specifically, source countries that rely significantly on consumption tax revenue, such as those in the E.U. and every OECD country except Australia and the United States,[19] will be most affected by an ineffective e-commerce tax regime because their tax bases will shrink substantially as the volume of tax-free[20] digital transactions becomes a larger portion of world trade.[21] Studying one country's proposed solution may assist the governments of E.U. member countries, for example, in applying their own consumption tax on goods and services, called the value-added tax ("VAT")[22] to international exchanges of digitized products.

Finally, the manner in which Singapore proposes to tax the value of and revenue from exchanges in digitized products will impact U.S. e-vendors that sell those goods and services. Singapore and the United States have not negotiated a tax treaty, which raises the possibility that U.S. e-vendors of digitized goods and services could face double-taxation. For example, if Singapore determines that the income from a sale of digitized goods constitutes royalty income for the use of a copyright, the exchange

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[15] INCOME TAX GUIDE, *supra* note 6; GST GUIDE, *supra* note 6.

[16] Stephen Lawson, *Report: China to Tax E-Commerce* (Aug. 4, 2000), *at* http://www.cnn.com/2000/TECH/computing/08/04/china.online.tax.idg/; Lori Enos, *Report: China to Tax E-Commerce* (July 4, 2000), *at* http://www.ecommercetimes.com/news/articles2000/000724-6.shtml.

[17] Martin Crutsinger, *U.S., Japan Sign Agreement to Keep the Internet Tax-Free*, SEATTLE TIMES, May 15, 1998, http://seattletimes. nwsource.com/news/nation-world/html98/grup_051598.html.

[18] *Singapore Focus: a Blueprint for an E-Commerce Hub in Asia*, *supra* note 13.

[19] *See* Chan, *supra* note 8.

[20] "Tax-free" is not meant to imply that e-commerce is not currently subject to taxes. The term, as used throughout this Comment, refers to the current circumstances and Internet architecture, which enable a large portion of the income and consumption from e-commerce transactions, in particular those of digitized products, to escape tax enforcement.

[21] Chan, *supra* note 8, at 250 (citing Kimberly A. Strassel and Jennifer L. Schenker, *OECD Summit to Focus on Internet-Tax Collection*, WALL ST. J. EUR., Sept. 15, 1998, at 8).

[22] The VAT is a form of consumption tax that is paid by producers, intermediaries, and retailers at each step in the production and retail chain. The tax is passed on to consumers, and the producers, intermediaries, and retailers receive tax credit for the VAT tax paid to prevent double-taxation. *Id.* n.101 (citing Christopher Deal, *The GATT and VAT: Whether VAT Exporters Enjoy a Tax Advantage Under the GATT*, 17 LOY. L.A. INT'L & COMP. L.J. 649 (1995)).

would be subject to a withholding tax in Singapore.[23] However, under current U.S. tax law, credit for foreign taxes is only given to the extent that the foreign taxes are imposed on "foreign-source income."[24] At best, only fifty percent of royalty income is foreign-source income,[25] so the U.S. e-vendor would have to pay both Singapore withholding tax and U.S. income tax on part of the same income, unless a bilateral tax treaty provides otherwise.

Thus, the manner in which the IRAS taxes international e-commerce transactions of digitized products has important implications from which the international community may learn. An e-commerce tax policy that raises the appropriate amount of revenue at the right time in an efficient and fair manner has yet to be established.

B. *Taxing E-Commerce Transactions Of Digitized Products Is Difficult*

E-commerce generally refers to transactions involving the exchange of goods or services between two or more parties over open telecommunications networks, like the Internet.[26] Examples of e-commerce include the following:

> (1) Retailing and wholesaling of physical or tangible goods (e.g. ordering a book through a website, and having the company ship it to the customer);[27] and
>
> (2) Retailing and wholesaling of digitized goods, or providing services, including financial services, through a website (e.g., the MusicNow.com example above).[28]

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[23] INCOME TAX GUIDE, *supra* note 6, para. 11.1.

[24] Ned Maguire, *supra* note 7, at 27.

[25] *Id*; Treas. Reg. § 1.863-3(b) (1996). For a more detailed explanation, see *infra* note 166 and accompanying text.

[26] Chan, *supra* note 8, at 237 (citing OECD, OECD POLICY BRIEF NO. 1-1997 (1997), http://www.oecd.org/publications/Pol_brief/9701_pol.htm); Cockfield, *supra* note 2, at 150 (citing Office of Tax Policy, U.S. Dep't of the Treasury, Selected Tax Policy Implications of Global Electronic Commerce § P3.2.1, at 6 (1996), http://www.fedworld.gov/pub/tel/internet.txt (last visited Oct. 1, 1999)).

[27] Chan, *supra* note 8, at 238 (citing Kyrie E. Thorpe, *International Taxation of Electronic Commerce: Is the Internet Age Rendering the Concept of Permanent Establishment Obsolete?*, 11 EMORY INT'L L. REV. 633, 647-49 (1997) (stating that the most prevalent classes of sales and transactions which take place on the Internet are: retailing and wholesaling, computer software, photographs, online information, services, health care, electronic gambling, and stock trading)).

[28] *Id.*

Aside from tax enforcement and administration issues (e.g., detecting whether and when an e-commerce transaction has occurred), transactions of digitized products raise unique tax concerns for both the source and resident countries. First, in transactions of digitized products, it is difficult to establish a source country's power to tax the income or consumption derived from the exchange. The Internet's current architecture allows downloaded or "imported" digitized products to bypass border checkpoints undetected[29] and to be made anywhere in the world without any determinative information regarding a customer's physical location.[30] However, under current international tax rules, accurate determination of the customer's physical location is a prerequisite to establishing a source country's jurisdiction to tax the value of the sale or revenue therefrom.[31] An alternative to source-based taxation is to base tax jurisdiction on the e-vendor's residence.[32] However, this solution would be unacceptable to countries with relatively few resident e-vendors.[33] A tax regime in which the e-vendor would be subject only to resident-state taxes would mean that states—namely the United States—with many resident e-vendors compared to other states, would reap the lion's share of e-commerce-derived tax revenue,[34] and source countries that rely on consumption taxes would lose a significant portion of their tax base.[35]

Second, how the income from a digital transaction should be characterized has not been settled, and is therefore a meaningful inquiry for tax purposes. There is a danger that some countries may characterize income from transactions of digitized goods and services differently from their physical analogs in order to gain jurisdiction to tax a digital exchange that they otherwise would not be able to tax under current tax rules.[36] For example, importing a CD generates business income, which the source country may tax only if the seller has a permanent establishment in that

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[29] Maguire, *supra* note 7, at 25.

[30] Kobrin, *supra* note 5, at 671.

[31] Cockfield, *supra* note 2, at 180.

[32] Chan, *supra* note 8, at 248. Also, a policy that based tax jurisdiction on the e-vendor's residency would provide a tax incentive for e-vendors to locate in countries with no or low corporate taxes. AUSTRALIAN TAX OFFICE, TAX AND THE INTERNET: SECOND REPORT 107, para. 5.3.54 (1999), http://www.ato.gov.au/content.asp?doc=/content/businesses/ecommerce_tati2.htm (last visited Apr. 20, 2001). Whether this incentive is great enough to affect e-vendors' choice of residency is a separate question, since there are other variables, such as access to capital, that significantly affect such a decision. *Id.*

[33] Chan, *supra* note 8, at 254 (citing Kimberly Strassel, *Internet's Relative Economic Impact is Played Down in Report by OECD*, WALL ST. J. EUROPE, Sept. 28, 1998, at B9H).

[34] *Id.*

[35] *Id.* at 250; Cockfield, *supra* note 2, at 159.

[36] Maguire, *supra* note 7, at 27.

country.[37] However, because a foreign e-vendor of digitized music will not likely have a physical presence in the source country, the source country may attempt to characterize the transaction as payment for the use of a copyright giving rise to royalty income,[38] since the purchaser may easily make and sell copies of the work. Royalty income is generally subject to a withholding tax in the source country, even if the foreign e-vendor does not have a permanent establishment in the source country.[39] In the absence of a tax treaty, such inconsistent tax treatment could subject e-vendors of digitized goods and services to double-taxation.[40] Moreover, inconsistent tax treatment between digitized products and their non-digitized analogs can create negative economic distortions in the marketplace, by artificially encouraging the consumption of one form of the product over another.

The fundamental problem in taxing international e-commerce transactions of digitized products is that the power to tax is geographically-based,[41] whereas the current architecture of cyberspace rejects the concept of geographical borders.[42] If the Internet's architecture somehow imposed the geographical borders that exist in the physical world onto cyberspace and e-commerce, ascertaining tax jurisdiction would simply involve applying familiar concepts and there would be no incentive to tax transactions in digitized products differently from their physical analogs.[43] In the absence of a geographically-based Internet architecture[44] or international agreement of e-commerce tax rules, however, taxing international e-commerce transactions in digitized products will present difficulties. Thus, some critics legitimately question whether these transactions should be taxed at all.

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[37] *Id.* at 26.

[38] *Id.* at 27.

[39] *Id.*

[40] *Id.* For a discussion of double-taxation, see *supra* Part II.A.

[41] For example, generally the country with income or consumption tax jurisdiction is the one where the income is deemed to be earned or where the product is said to be consumed. *See supra* notes 3-6 and accompanying text.

[42] Kobrin, *supra* note 5, at 671.

[43] However, whether such an Internet architecture would be desirable or beneficial beyond tax considerations is another matter.

[44] Whether a geographically-based Internet architecture would be desirable is an important inquiry, but beyond the scope of this Comment, which assumes the current Internet architecture.

C. *Ask Not Whether To Tax E-Commerce, But When and How*

The volume and value of global e-commerce transactions are increasing rapidly. The OECD estimates that the level of e-commerce will expand from its approximate 1998 value of US$26 billion to US$1 trillion by 2005.[45] Worldwide e-commerce transactions will likely comprise a significant percentage of total world trade. Thus, it seems countries must determine how to tax e-commerce transactions in order to maintain their tax bases without economically distorting the global economy. Countries must pursue these objectives while allowing the e-commerce industry to develop, unimpeded by arduous or unnecessary regulations or restrictions.[46] The issues to be resolved do not include whether to tax e-commerce, but when and how e-commerce transactions should be taxed.

Several problems will arise if e-commerce remains tax-free due to the ineffectiveness of present tax policy. Source countries' tax bases will likely shrink or lose a lucrative source as the volume of e-commerce grows.[47] Contraction of the tax base will result if the fall in income and sales tax collected and the decline in income tax collected from workers displaced by e-commerce technologies[48] are greater than the decrease in unemployment as a result of the creation of new opportunities created by e-commerce technologies.[49] Moreover, tax-free e-commerce creates an economic inefficiency. The market will be artificially skewed toward e-commerce because it will be cheaper to purchase goods and services online than through traditional means.[50] Thus, tax-free e-commerce acts as a subsidy to e-vendors. This may not be the most efficient resource allocation.

Proponents of a tax-free Internet argue that the ineffectiveness of international tax policy with respect to e-commerce is not a problem that should be solved now or in the near future. One argument is that taxing the relatively infant e-commerce industry may slow its development[51] and

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45 Chan, *supra* note 8, at 236 (citing Heather Scoffield, *E-commerce Expected to Explode, OECD Says*, GLOBE & MAIL, Sept. 29, 1998, at B6).

46 *See* Maguire, *supra* note 7, at 24.

47 *See supra* note 21 and accompanying text.

48 *See* Chan, *supra* note 8, at 250 (citing Arthur J. Cordell, *New Taxes for a New Economy*, http://www.usask.ca/library/giv/v2n4/cordell/cordell.html (visited October 3, 1998) (originally presented September 14, 1995 at Victoria University in University of Toronto, before the World Leadership Conference)).

49 Risaburo Nezu, *E-Commerce: A Revolution with Power*, OECD Observer, Oct. 6, 2000, http://www.oecdobserver.org/news/fullstory. php/aid/344.

50 Peter Cobb et al., *Taxing E-Commerce: The Landscape of Internet Taxation*, 21 U. PA. J. INT'L ECON. L. 659, 662 (2000); *cf.* Adrian J. Sawyer, *Electronic Commerce: International Policy Implications for Revenue Authorities and Governments*, 19 VA. TAX REV. 73, 84 (1999).

51 Maguire, *supra* note 7, at 24; Kobrin, *supra* note 5, at 666.

negatively impact economic growth. A tax on e-commerce transactions could discourage people from purchasing goods and services over the Internet.[52] More regulation and less revenue could prevent the level of investment that the e-commerce industry requires to develop and grow.[53] Any e-commerce tax solution should come in the context of e-commerce's evolution so as not to deter inadvertently any entrepreneurial effort to develop a particular aspect of e-commerce.[54] Hence, the arguments of those who wish to keep e-commerce tax-free focus only on the appropriate timing of when e-commerce should be taxed.

A failure to provide effective, efficient, and fair international e-commerce tax rules, however, may hinder the development and growth of e-commerce and the global economy even more than having a positive taxation scheme. E-vendors may postpone expansion plans for fear of incurring the financial cost and administrative burden of complying with uncoordinated international taxation schemes.[55] This would result in an inefficient allocation of industry resources, and less revenue, development, and growth. In addition, e-commerce and economic growth might be adversely affected because small- and medium-sized enterprises, which historically have conducted a large share of international e-commerce, often may not have the resources or knowledge to comply with disparate tax laws from myriad jurisdictions.[56]

Thus, the debate between those that wish to tax international e-commerce transactions has shifted from whether e-commerce should be subject to international taxes to when taxation should occur. The proper timing of taxing international e-commerce transactions so as not to excessively discourage e-commerce development and economic growth is beyond the scope of this Comment. However, if income and consumption from international trade in digitized products are to be taxed, the framework of an appropriate tax regime should be discussed before the volume of tax-free e-commerce transactions of digitized products significantly erodes countries' tax bases.

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[52] Hal R. Varian, *Taxation of Electronic Commerce*, 13 HARV. J.L. & TECH. 639, 639 (2000) (citing an online survey of 7,000 online buyers at point of sale, conducted by Bizrate.com in September 1999); *cf.* Cobb et al., *supra* note 50, at 662.

[53] *See* Maguire, *supra* note 7, at 24.

[54] OFFICE OF TAX POLICY, U.S. DEP'T OF THE TREASURY, SELECTED TAX POLICY IMPLICATIONS OF GLOBAL ELECTRONIC COMMERCE 4 (1996), http://www.ustreas.gov/taxpolicy/documents.html.

[55] Chan, *supra* note 8, at 239 (citing Neal Friedman, *The Legal Challenge of the Global Information Infrastructure*, 2 CYBERSPACE L. No. 10, at 8 (1998) (providing a general history of the Internet)).

[56] Cockfield, *supra* note 2, at 183-84. However, technological solutions may be developed to lower such compliance costs.

III. ANY E-COMMERCE TAX REGIME SHOULD BE NEUTRAL, EFFICIENT, CLEAR AND SIMPLE, EFFECTIVE AND FAIR, AND FLEXIBLE

A primary goal of most tax regimes is to raise the appropriate amount of revenue at the right time without introducing unnecessary economic distortion or disruption into the marketplace.[57] In pursuit of that objective, the thirty member economies of the OECD are in the process of developing principles and recommendations to which countries' e-commerce tax regimes should adhere. There are a few reasons why the OECD's pronouncements on the taxation of international e-commerce transactions are appropriate standards by which to evaluate how a country, like Singapore, proposes to tax e-commerce. First, the OECD's principal purpose is to provide governments with a forum to discuss, develop, and perfect economic and social policy,[58] such as how best to tax e-commerce. The international community recognizes and respects the OECD's proven ability to rationalize difficult international tax matters.[59] Second, the OECD's Model Tax Convention is believed to be the most influential model tax treaty.[60] Singapore's bilateral tax treaties are based on the OECD's Model Tax Convention.[61] Third, Singapore's market-oriented economy, which has one of the world's highest per-capita Gross Domestic Products,[62] is just as developed as the OECD's thirty member economies,[63] which

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[57] *See* COMM. ON FISCAL AFFAIRS, ORG. FOR ECON. CO-OPERATION AND DEV., ELECTRONIC COMMERCE: TAXATION FRAMEWORK CONDITIONS, 34, pt. I, para. 2, IV, para. 9(i), 9(iv), http://www.oecd.org/daf/fa/e_com/public_release.htm [hereinafter OECD TAXATION FRAMEWORK].

[58] ORG. FOR ECON. CO-OPERATION AND DEV., WHAT IS OECD?, *at* http://www.oecd.org/about/general/index.htm.

[59] Maguire, *supra* note 7, at 25 (positing that "the OECD has a long record of rationalizing difficult international tax matters" and that "[i]t appears that the governments studying taxation of e-commerce will forego unilateral measures in favor of awaiting the results of the OECD work").

[60] Cockfield, *supra* note 2, at 133 n.2. Nearly 350 treaties between OECD Member countries and over 1500 tax treaties world-wide are based on the OECD Model Tax Convention, and it has had considerable influence on the bilateral treaties between non-member countries, as well. Articles of the OECD Model Tax Convention on Income and Capital, http://www.oecd.org/daf/fa/material/mat_07.htm#material_Model articles.

[61] PRICEWATERHOUSECOOPERS, DOING BUSINESS AND INVESTING IN: SINGAPORE ch. 23, *at* http://209.41.108.131/guides/singapore/toc.htm.

[62] THE WORLD BANK GROUP, COMPETITIVENESS INDICATORS, http://wbln0018.worldbank.org/psd/compete.nsf.

[63] The membership of OECD is not closed; however, its thirty member countries share the principles of the market economy, pluralist democracy, and respect for human rights. These countries are (in alphabetical order): Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States. Org. for Econ. Co-operation and Dev., *OECD Membership*, *at* http://www.oecd.org/about/general/member-countries.htm.

produce two-thirds of the world's goods and services.[64] Therefore, applying economic tax principles and recommendations negotiated by developed countries to Singapore is not unreasonable.

To raise the right amount of revenue at the right time without undue economic burden, the OECD emphasizes that a tax on international e-commerce exchanges of digitized goods and services should adhere to the following five core principles:[65]

> (1) Taxation should be neutral.[66] In other words, taxpayers in similar situations, engaging in similar transactions of similar goods or services should pay similar taxes.[67] Failure to do so would introduce negative economic distortions into the marketplace.[68]
>
> (2) Taxation should be efficient.[69] The tax should not be too expensive to comply with or to administrate.[70]
>
> (3) Taxation should be clear and simple.[71] If the tax rules are too complex or vague to understand, scarce economic resources will not be allocated efficiently, since taxpayers will not know if, when, where, or how the tax is to be accounted for a given transaction.[72]
>
> (4) Taxation should be effective and fair.[73] In order to produce the right amount of revenue at the appropriate time, tax evasion, tax avoidance, and double taxation must be minimized by measures that are not too overbearing or restrictive.[74]
>
> (5) Taxation should be flexible.[75] Revenue could be lost if countries' tax bases erode due to technological or commercial developments, such as e-commerce.[76]

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64 ORGANISATION FOR ECON. CO-OPERATION AND DEV., *supra* note 58.
65 OECD TAXATION FRAMEWORK, *supra* note 57, at 4, pt. IV, paras. 9(i)-(v).
66 *Id.* at 4, pt. IV, para. 9(i).
67 *Id.*
68 *See supra* note 50 and accompanying text.
69 OECD TAXATION FRAMEWORK, *supra* note 57, at 4, pt. IV, para. 9(ii).
70 *Id.*
71 *Id.* para. 9(iii).
72 *Id.*
73 *Id.* para. 9(iv).
74 *Id.*
75 *Id.* para. 9(v).
76 *Id.*

Additionally, the OECD recommends that a framework for the taxation of international e-commerce transactions of digitized products include the following policies:

(1) Consumption should be taxed where the consumption occurs (i.e., in the source country), as opposed to where the e-vendor resides.[77] An international tax policy based on the e-vendor's residency would not fairly apportion e-commerce tax revenues between countries, would lead to a decline in a source country's tax base, and would provide a tax incentive for e-vendors to locate their businesses in countries with low or no consumption tax.[78]

(2) The supply of digitized products should not be treated as a supply of goods for consumption tax purposes.[79] Tax or customs officials can collect a consumption tax on tangible goods at the point they are imported into the country.[80] Digitized products require different treatment because they bypass conventional importation points undetected by tax officials.[81]

(3) Countries should implement mechanisms to effectively and efficiently capture the consumption tax on exchanges of digitized products.[82] Requiring consumers to pay a tax on their consumption of digitized products is insufficient to prevent tax base erosion.[83] An effective tax policy must also provide a clear and adequate mechanism to collect the tax.[84]

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[77] *Id.* at 5, pt. V, para. 11(v).

[78] *See supra* notes 34-35 and accompanying text.

[79] *See supra* note 57, at 5, pt. V, para. 11(vi).

[80] For example, the Customs and Excise Department collects a consumption tax on goods that are imported into Singapore. *Business Operations in Singapore*, Tax Management: Foreign Income Portfolios (BNA) No. 983-2d, at A-35 (1998) [hereinafter BNA].

[81] *See supra* note 29 and accompanying text.

[82] OECD TAXATION FRAMEWORK, *supra* note 57, at 5, pt. V, para 11(viii).

[83] *See* Chan, *supra* note 8, at 251 (stating that "[s]ince consumption taxes are a tax on sales, any lost taxes on undetected consumption of products conducted over the Internet would mean a proportional loss to the country's tax base.").

[84] *Id.*

(4) To determine whether a transaction of digitized products results in ordinary income or royalty income (i.e., a payment for the use of or right to use a copyright), source countries should look to the "essential consideration" for the payment:

> Where the essential consideration is for something other than for the use of, or right to use, rights in the copyright (such as to acquire other types of contractual rights, data or services), and the use of copyright is limited to such rights as are required to enable downloading, storage and operation on the customer's computer, network or other storage, performance or display device, such use of copyright should be disregarded in the analysis of the character of the payment for purposes of applying the definition of "royalties."[85]

For example, payments that entitle a customer (business entity or individual) to electronically download digitized products (e.g., music, images, sound, text) for that customer's own use or enjoyment should not constitute royalties.[86] The essential consideration for the payment in this situation is not the possibility that the customer could easily copy and resell the copyrighted work, but the customer's own use and enjoyment.[87] On the other hand, if a customer paid for the right to download and reproduce for resale a copyrighted, digitized picture or song, then the essential consideration for the payment is the acquisition of rights to use the copyright in the digitized product.[88] This latter transaction should give rise to royalty income.[89]

(5) Income tax jurisdiction should be based on where the e-vendor conducts the essential business activities that create the income.[90] A website (including the website hosting arrangement with a local

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[85] TECHNICAL ADVISORY GROUP ON TREATY CHARACTERISATION OF ELECTRONIC COMMERCE PAYMENTS, ORG. FOR ECON. CO-OPERATION AND DEV., TAX TREATY CHARACTERISATION ISSUES ARISING FROM E-COMMERCE, 6, para. 17.2 (2001), http://www.oecd.org/daf/fa/e_com/public_release.htm [hereinafter OECD Income Characterization].

[86] *Id.* at 6, para. 17.3.

[87] *Id.*

[88] *Id.* at 6, para. 17.4.

[89] *Id.*

[90] OECD Committee on Fiscal Affairs, *Clarification on the Application of the Permanent Establishment Definition in E-Commerce: Changes to the Commentary on the Model Tax Convention on Article 5*, at 6, paras. 42.8, 42.9, http://www.oecd.org/daf/fa/e_com/public_release.htm (Dec. 22, 2000) [hereinafter OECD Permanent Establishment].

Internet Service Provider), along with the computer equipment (e.g., a server) should not, by their mere presence in a source state, constitute a permanent establishment.[91] However, if the equipment is fixed (i.e., at a certain physical location for a period of time so as to become fixed) or if the e-commerce operations carried on through the website or computer equipment are core or essential and significant parts of an enterprise's business activity, a website or computer equipment could be deemed a permanent establishment for income tax purposes.[92] Thus, to determine whether the source country has income tax jurisdiction, the OECD recommends looking to the essential business activities of the e-vendor that are conducted in the source state through whatever means (i.e., the "essential business activities" test).

IV. SINGAPORE'S E-COMMERCE TAX REGIME

The IRAS seeks to tax both the income that foreign e-vendors earn from sources in Singapore and the value of the goods and services that domestic residents consume through e-commerce. To this end, the IRAS extends its existing income and consumption tax policies to e-commerce transactions.[93] Because taxing international e-commerce transactions of digitized products presents significant and unique tax issues, this Part specifically focuses on the provisions of Singapore's income and consumption tax policies that affect such commercial exchanges and how a U.S. e-vendor, such as MusicNow.com, is expected to operate under those provisions.

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[91] *Id.* at 3-6, paras. 6, 14, 42.4, 42.8.

[92] *Id.* at 5-6, paras. 42.4, 42.8.

[93] INCOME TAX GUIDE, *supra* note 6; GST GUIDE, *supra* note 6.

A. *Application of Singapore's Goods and Services Tax ("GST") to International E-Commerce Transactions of Digitized Products*

1. *Singapore's GST Regulations Affecting International E-Commerce Transactions of Digitized Products*

The Singapore government promulgated the Goods and Services Tax ("GST") Act on April 1, 1994.[94] The GST is a tax on domestic consumption,[95] modeled after the United Kingdom's Value Added Tax ("VAT").[96] A supply of imports to Singapore is subject to three percent GST[97] if all of the following conditions are met:

> (1) The foreign supplier or domestic importer is registered for GST (i.e., the entity supplies taxable goods and services in Singapore of a value exceeding or expected to exceed S$1 million,[98] or US$551,389.50,[99] annually).[100]
>
> (2) The imported goods or services do not fall into one of the following categories:
>
> > (a) Goods or services that are expressly exempt from GST under the Fourth Schedule to the GST Act.[101] The main exemptions are for leases or sales of residential properties and for financial services.[102]
> >
> > (b) Goods or services that are taxable, but "zero-rated" (i.e., attract GST at zero percent) under section 21 of the GST Act, namely exported goods or services and international transportation services (e.g., the sale of airline tickets).[103]

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94 BNA, *supra* note 80, at A-35, para. F (citing Goods and Services Tax Act 1993 (No. 31 of 1993)).

95 *Id.* at para. F1; GST GUIDE, *supra* note 6, para. 2.1.

96 BNA, *supra* note 80, at A-35. para. F.

97 *Id.* at paras. F1, 2; GST GUIDE, *supra* note 6, para. 2.1.

98 "S$" represents the Singapore dollar.

99 S$1 million multiplied by the daily twelve noon U.S.$/S$ exchange rate for April 20, 2000 (U.S.$1 / S$1.8136) (published by the Federal Reserve Bank of New York, http://www.ny.frb.org/pihome/statistics/forex12.shtml).

100 BNA, *supra* note 80, at A-35, para. F7; GST GUIDE, *supra* note 6, para. 2.4.

101 BNA, *supra* note 80, para. F1.

102 *Id.*; GST GUIDE, *supra* note 6, para. 2.2.

103 GST GUIDE, *supra* note 6, paras. 2.2, 3.2.1, app. 1.

(3) The supply is "made in Singapore," specifically:[104]

(a) If physical goods are delivered in Singapore;[105] or

(b) If the services or digitized goods are provided for or to someone who "belongs in Singapore" when the services are performed or the digitized goods delivered,[106] or if the services are supplied in direct connection with land or goods situated in Singapore.[107] An individual customer belongs in Singapore if that person usually resides in Singapore.[108] A customer who is a business entity belongs in Singapore if it has a business or fixed establishment in Singapore.[109]

A GST-registered e-vendor must take reasonable steps to determine whether a customer "belongs in Singapore."[110] A customer will be treated as belonging in Singapore for GST purposes if the customer has a Singapore domain name or a Singapore IP address.[111] If not, then the e-vendor should, at the time the transaction is made, obtain a declaration from the customer as to her usual place of residence or where her business is located.[112] If the customer does not respond, the e-vendor should charge the three percent GST.[113]

Generally, it is the GST-registered supplier's responsibility to charge and collect GST and to remit the tax to the GST Comptroller.[114] However, GST may be recovered by a GST-taxable entity if the supply is to be used for a taxable activity (e.g., used in the production of another product to be sold).[115]

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104 *Id.* para. 2.1.
105 *Id.* para. 3.1.1.
106 *Id.* paras. 3.2.1, 3.2.5.
107 *Id.* app. I(e), (f), (g), and (j).
108 *Id.* para. 3.2.2.
109 *Id.*
110 *Id.* para. 3.2.4.
111 *Id.* app. II.
112 *Id.*
113 *Id.*
114 GST GUIDE, *supra* note 6, para. 2.3.
115 BNA, *supra* note 80, at A-36.

2. *The IRAS Treats Digitized Products as Services Under the GST*

Although the same criteria will apply to e-commerce transactions of digitized goods and services, the Internet's current architecture requires that digitized products be treated differently than their physical analogs for tax purposes. Whether a supply of tangible goods is subject to GST depends in part on where the goods are delivered (i.e., whether imported to Singapore or not).[116] The Customs and Excise Department of Singapore is able to collect the tax from the consumer (if the value of the goods is greater than S$400 (US$220.56[117]))[118] at the place where the goods are imported into Singapore.[119] Digitized products, however, require different treatment because they bypass conventional importation points[120] under the Internet's current infrastructure. To address this tax collection concern, Singapore's GST regime treats the supply of digitized products as a supply of services.[121] In other words, if the e-vendor is GST-registered, the product sold is not exempt or zero-rated, and the customer belongs in Singapore when the service is provided or the good is delivered, then the e-vendor must charge GST.

Unfortunately, when the e-vendor is foreign, it is difficult to ascertain whether GST will be charged if the supply of digitized products is treated as a supply of services. On one hand, the IRAS states that consumers "importing" or downloading digitized products from a supplier that does not belong in Singapore need not pay GST.[122] However, the IRAS also specifies that GST-registered e-vendors selling digitized products over the Internet must charge GST unless the customer does not belong in Singapore.[123] One interpretation to these seemingly conflicting policies is that the IRAS may intend not to tax domestic consumption of digitized products purchased from a foreign e-vendor. Under such a policy, MusicNow.com, the U.S. e-vendor in our example above, would not have to charge or remit Singapore GST on sales to Singapore customers.

Alternatively, this apparent conflict may be resolved by concluding that while customers who purchase digitized products from foreign e-

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[116] BNA, *supra* note 80, at A-35.
[117] For the U.S.$ / S$ exchange rate used, see *supra* note 99.
[118] GST GUIDE, *supra* note 6, para. 3.1.3.
[119] BNA, *supra* note 80, at A-35.
[120] *See supra* note 29 and accompanying text.
[121] GST GUIDE, *supra* note 6, para. 3.1.3 n.3. Note that this is consistent with the OECD's recommendation not to treat the supply of digitized products as a supply of goods. *See supra* notes 79-81 and accompanying text.
[122] *Id.* para. 3.1.3.
[123] *Id.* paras. 3.2.1, 3.2.5.

vendors need not remit GST to the GST Comptroller, the foreign e-vendor that sells digitized goods or services to a customer who belongs in Singapore is responsible for collecting and remitting GST to the GST Comptroller. Under this interpretation, assuming MusicNow.com annually supplies to Singapore more than S$1 million of taxable products,[124] MusicNow.com would be responsible for making a reasonable effort to determine whether its customer, John, has a Singapore domain name, a Singapore IP address, or usually resides in Singapore.[125] If so, John belongs in Singapore for GST purposes, and MusicNow.com, having already ascertained that the digitized music and service it is selling to John are not GST exempt or zero-rated,[126] must charge three percent GST on the transaction, and remit that amount to Singapore's GST Comptroller.[127] How the IRAS decides to harmonize these two seemingly contradictory rules will have different tax and economic consequences.[128]

B. *Application of Singapore's Income Tax to International E-Commerce Transactions of Digitized Products*

Since 1947, the Singapore government has taxed income accrued in, or derived from, Singapore.[129] If the taxpayer's business operations are carried out in Singapore, then income derived from those operations is likely sourced in Singapore and subject to Singapore's income tax.[130] This "operations test" is fact-intensive, and whether a taxpayer is subject to Singapore income tax depends on the extent of the taxpayer's business operations in Singapore.[131]

Generally, income derived from e-commerce transactions between a foreign e-vendor of digitized products and a resident of Singapore will not be sourced in Singapore and subject to Singapore income tax.[132] However, to determine whether such income is derived in Singapore so as to be subject to Singapore income tax, the IRAS will apply the "operations test."[133] Factors of this test, as applied to e-vendors, include: the presence or absence of a permanent establishment or permanent physical presence in Singapore;

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[124] *See supra* note 100 and accompanying text.
[125] *See supra* notes 110-112 and accompanying text.
[126] *See supra* notes 101-103 and accompanying text.
[127] *See supra* note 114 and accompanying text.
[128] For further discussion of these tax and economic consequences, see *infra* Part V.C.
[129] BNA, *supra* note 80, at A-22(2); INCOME TAX GUIDE, *supra* note 6, para. 2.1.2.
[130] INCOME TAX GUIDE, *supra* note 6, para. 2.1.3.
[131] *Id.*
[132] *Id.* para. 7.2.3.
[133] *Id.* para. 2.1.3.

where contracts are formed; where acts under a contract are performed; where capital is employed; where the ownership rights in the goods changes hands; and where services are performed.[134] The IRAS has determined that a physical server located in Singapore is not a permanent establishment that would, by itself, give Singapore jurisdiction to tax the income from an e-commerce sale of digitized goods by a foreign e-vendor.[135] The IRAS also considers whether the foreign e-vendor's website design, promotion, advertising, updating, and hosting arrangement occur inside or outside Singapore.[136] Thus, while the IRAS recognizes that most foreign e-vendors of digitized products with no permanent establishment in Singapore will not be subject to Singapore income tax, the IRAS will make that determination on a case-by-case basis.[137]

C. E-Commerce Transactions of Digitized Products May Be Subject to Singapore Withholding Tax for Royalties

Foreign e-vendors that are not subject to Singapore income tax may still be exposed to Singapore withholding tax for royalties. A Singapore resident, or a permanent establishment in Singapore, must withhold tax on payments made for the "use of, or right to use of, [] digitized products"[138] (i.e., royalty payments for the use of, or right to use, a copyright). Aside from expressly exempting four categories of software from withholding tax, the IRAS has not articulated what other digitized goods and services will or will not give rise to royalty income and withholding tax when they are exchanged.[139] Currently, royalty income is subject to a fifteen percent withholding tax.[140]

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134 BNA, *supra* note 80, at A-23.
135 INCOME TAX GUIDE, *supra* note 6, para. 12.1.1.
136 *Id.* para. 7.2.2.
137 *See id.* para. 2.1.4.
138 *Id.* para. 7.2.4.
139 *See id.* para. 11.2.
140 BNA, *supra* note 80, at A-29.

V. INTERNATIONAL IMPLICATIONS OF SINGAPORE'S INCOME AND CONSUMPTION TAX POLICIES ON INTERNATIONAL E-COMMERCE TRANSACTIONS OF DIGITIZED PRODUCTS

Singapore seeks to tax the consumption and income derived from importing digitized goods and services[141] to forestall the erosion of its tax base. Although Singapore's e-commerce tax policy provides regulatory guidance and strives to incorporate and promote internationally accepted e-commerce tax principles and recommendations, it raises some concerns of exposing e-vendors of digitized products to double-taxation,[142] overly burdensome compliance costs, and unequal tax treatment, both between small- to medium-sized e-vendors and their larger competitors, and between e-vendors and their brick-and-mortar competitors. Solutions to these issues may require international agreement. Meanwhile, to alleviate U.S. e-vendors' double-taxation concerns, the United States should conclude a bilateral tax treaty with Singapore, and the IRAS should adopt the OECD's "essential consideration" test or otherwise clarify how it will characterize income derived from transactions in digitized products.

The OECD recommends that any e-commerce tax framework be flexible enough to accommodate future technological and commercial developments.[143] By adapting its existing income and consumption tax policies to the challenge of e-commerce, the IRAS has already shown the flexibility of Singapore's tax regime. However, the ability of the IRAS to tax international e-commerce transactions of digitized products in order to raise the appropriate amount of revenue at the right time without undue economic distortion or disruption depends on the extent to which Singapore's e-commerce tax policies adhere to the other four OECD principles and recommendations specific to the taxation of e-commerce.

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[141] *See generally* INCOME TAX GUIDE, *supra* note 6; GST GUIDE, *supra* note 6. *See supra* note 83 and accompanying text.

[142] International double-taxation occurs, for example, when a company, residing in country A, sells a product to a resident of country B and is taxed by both countries on the same income. For an illustration, see *infra* notes 165-167 and accompanying text.

[143] *See supra* notes 75-76 and accompanying text.

A. *Analysis of the Internal Revenue Authority of Singapore's E-Commerce Tax Policies in Light of OECD E-Commerce Tax Principles and Recommendations*

OECD	Singapore GST	Singapore Income Tax
Principles:		
• Neutral	• YES – Taxes both tangible and digitized products. • YES – Ensures GST is collected and remitted. • NO – If the IRAS does not tax domestic consumption of digitized products purchased from foreign e-vendors.	• YES – Same tax on income derived from both traditional commerce and e-commerce transactions of both tangible and digitized products. • NO – Failure to adopt "essential consideration" test or similar standard may lead to non-neutral income characterization.
• Efficient	• YES – GST registration S$1 million threshold for e-vendors minimizes administrative and compliance costs. • NO – E-vendor must obtain residency declarations.	• YES – IRAS specifies when "operations test" will be satisfied, giving rise to taxable income.
• Clear and Simple	• YES – Tax collection mechanism delineates who is to collect and remit GST, to whom it is to be remitted, when to collect and remit it, and how to collect and remit it.	• YES – IRAS specifies when "operations test" will be satisfied, giving rise to taxable income.
• Effective and Fair	• YES – Presence of bilateral tax treaty (i.e., with the United States) would address double-taxation issue. • NO – Absence of bilateral tax treaty may cause double-taxation. • NO – E-vendor must obtain residency declarations.	• YES – Foreign e-vendors of digitized products with no permanent establishment in Singapore (determined by applying "operations" test) are exempt. • YES – Presence of bilateral tax treaty or adoption of "essential consideration" test would address double-taxation issue. • NO—Absence of bilateral tax treaty or failure to adopt "essential consideration" test may cause double-taxation.
• Flexible	• YES—Largely applies existing GST to e-commerce	• YES—Largely applies existing income tax to e-commerce

Recommendations:		
• Tax consumption where it occurs	• YES	Not applicble
• Do not treat a supply of digitized goods as a supply of tangible goods for consumption tax purposes.	• YES - Treats digitized products as services (i.e., tax jurisdiction depends on the consumer's usual place of residence).	Not applicable
• Tax collection mechanism	• YES - E-vendor must reasonably attempt to determine if customer "belongs in Singapore." If so, e-vendor responsible for collecting and remitting GST to GST Comptroller.	• YES - No change from current process.
• Income characterization: use "essential consideration" test to determine when royalty income will arise.	Not applicable	• NO-Income characterization regarding royalties is unclear (aside from four types of software).
• Use "essential business activities" test to determine tax jurisdiction.	Not applicable	• YES- The analogous "operations test" determines income tax jurisdiction in Singapore.

B. *Singapore's S$1 Million Registration Threshold Reduces Tax Administration and Compliance Costs*

Singapore's GST regime promotes the core principles of an effective international e-commerce tax policy by exempting all transactions involving suppliers that do not make annual taxable supplies to Singapore of more than S$1 million.[144] This threshold helps to reduce the tax compliance costs of the small- and medium-sized enterprises that currently typify e-vendors of digitized products.[145] Moreover, the threshold level, similar to the permanent establishment requirement, reduces the administrative costs associated with ascertaining the proper tax treatment of every transaction and policing the compliance of enterprises that do not derive a significant amount of revenue from Singapore.[146] The IRAS is thereby able to minimize the compliance burden (i.e., increase the efficiency of the tax) and preserve the tax base by taxing e-vendors that do a substantial amount of

144 BNA, *supra* note 80, at A-36; GST GUIDE, *supra* note 6, paras. 2.3-2.4.
145 Cockfield, *supra* note 2, at 200.
146 *Id.*

business in Singapore but that do not have a permanent establishment in Singapore.

C. *The IRAS Should Clarify that Foreign E-Vendors Selling Digitized Products to Singapore Residents Must Charge, Collect, and Remit GST to the GST Comptroller*

Singapore's GST regime treats the supply of digitized products as services, which is consistent with the OECD's recommendation not to treat the supply of digitized products as a supply of goods.[147] This policy recognizes that digitized products that are sold and delivered internationally through the Internet bypass traditional border checkpoints where GST can be collected.[148] However, when the e-vendor is foreign, it is difficult to ascertain whether GST will be charged if the supply of digitized products is treated as a supply of services.

If, in treating the supply of digitized products as a supply of services, the IRAS does not tax domestic consumption of any digitized product purchased from a foreign e-vendor, at least two fundamental problems will arise. First, Singapore's consumption tax base will shrink as international e-commerce transactions of digitized products become a larger portion of world trade. Generally, the IRAS taxes consumption in Singapore—where the consumption occurs.[149] This policy helps ensure that tax revenue from transactions of digitized products is shared more equitably between the foreign e-vendor's resident state and Singapore. However, if the IRAS does not tax domestic consumption of digitized products bought from foreign e-vendors, then Singapore will not capture any tax revenue from such transactions, resulting in a smaller consumption tax base.

Second, this IRAS policy will not be tax neutral, thereby economically distorting the marketplace. The IRAS will continue to tax the consumption of music imported on a compact disc, for example, but not if that same music is digitized and imported through the Internet. Such a non-neutral tax policy will favor digitized goods supplied through the Internet over their physical analogs. Moreover, Singapore e-vendors of digitized products will be subject to GST, but not their foreign competitors. For these reasons, not taxing domestic consumption of digitized products purchased from foreign e-vendors would make Singapore's e-commerce tax regime significantly less attractive as a model for other economies to emulate.

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[147] *See supra* notes 79-81 and accompanying text.
[148] *See supra* note 29 and accompanying text.
[149] GST GUIDE, *supra* note 6, para. 2.1.

In order to preserve the consumption tax base and tax neutrality between tangible and intangible products, the IRAS should simply condition the power to tax digitized products upon the same determinant of the taxation of services—that is, whether the consumer "belongs in Singapore" at the time the service is provided or the good delivered.[150] Tax revenue between the resident state and Singapore will be shared more equitably; digitized products provided over the Internet will be taxed like their physical analogs; and all e-vendors of digitized products, foreign or domestic, will be subject to the GST. In addition, by requiring GST-registered e-vendors whose supply of digitized products is considered to be made in Singapore to collect the three percent GST and remit it to the GST Comptroller,[151] the parties to a transaction of digitized products know when GST is to be collected, by whom GST is to be collected, and how and to whom GST is to be remitted. This tax treatment of digitized products is clear and simple to understand and preserves tax neutrality by ensuring that the GST on consumption of digitized products in Singapore is actually collected and remitted.

D. The U.S. and Singapore Governments Should Conclude a Bilateral Tax Treaty to Address Double-Taxation Concerns, and the IRAS Should Monitor the Economic Effects of the GST Registration Threshold and Consumer Residency Requirements

Assuming that foreign e-vendors selling digitized products to Singapore residents must charge, collect, and remit GST to the GST Comptroller, Singapore's GST regime may concern GST-registered e-vendors that reside in states, such as the U.S., that have not concluded a bilateral tax treaty with Singapore. U.S. e-vendors, for example, may be subject to double-taxation. In our example above, MusicNow.com would pay three percent of the value of the sale to Singapore's Comptroller of GST. Since the United States taxes the income of U.S. residents no matter where the income was generated,[152] the United States grants tax credits to its multinational firms for foreign income taxes paid. The problem is that the three percent GST paid by MusicNow.com is a tax on consumption, not income, and therefore may not qualify for the tax credit, especially because, unlike a net basis income tax, the GST is imposed on a gross basis without

[150] *See supra* notes 106-112 and accompanying text.

[151] *See supra* note 114 and accompanying text.

[152] Joseph L. Andrus & Robert H. Dilworth, *Financing International Operations of U.S. Multinationals*, 483 PLI/TAX 161, 168 (2000).

any allowable deductions.[153] Thus, to the extent that MusicNow.com does not pass the cost of the tax to John in Singapore, it will incur both the Singapore GST and U.S. income tax on the same revenue. The United States and Singapore could solve this problem by negotiating a bilateral tax treaty, which would eliminate the possibility of double-taxation.[154]

Singapore's GST also may put companies like MusicNow.com at a tax cost disadvantage to competitors whose business with Singapore customers falls below the threshold amount. These competitors are GST-exempt, which directly makes the goods or services they supply cheaper by as much as three percent and indirectly lowers their costs because they will not incur the cost of complying with the GST. Thus, while the S$1 million GST registration threshold is tax efficient because it minimizes administrative and compliance costs, the threshold economically distorts the marketplace by favoring small e-vendors over their larger competitors for GST purposes. It remains to be determined whether large e-vendors may be able to duck under the threshold by selling the same or similar product through subsidiaries or affiliates, none of which would make more than S$1 million in gross sales to Singapore customers. Further, whether the S$1 million threshold level appropriately balances efficiency (i.e., keeps compliance and administrative costs to a minimum) with the need to maintain the tax base must be evaluated.

Several problems stem from the intent of the IRAS to tax the consumption of digitized products made by anyone who usually resides in Singapore or has a Singapore domain name or IP address. This policy will require e-vendors of digitized products to obtain declarations from every customer whose usual place of residency is ambiguous, which may include customers with Singapore domain names or IP addresses to the extent such indicators do not accurately reflect residency. Note that this will impact all e-vendors of digitized products, not just large e-vendors, because it will be impossible for an e-vendor to know whether it must pay GST if it does not know the volume of transactions it makes with Singapore residents. This could be a burden so onerous as to invite noncompliance, thereby significantly weakening Singapore's GST regime.[155]

Additionally, this policy also allows the IRAS to tax the consumption of digitized goods that Singapore residents make even when they are outside

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[153] *See* Cockfield, *supra* note 2, at 179.

[154] *See id.*

[155] *See generally* Organization for Econ. Co-operation and Dev., *Consumption Tax Aspects of Electronic Commerce*, Draft Report from Working Party No. 9 on Consumption Taxes to the Committee on Fiscal Affairs, Feb. 2001, at 15, para. 45.

Singapore's borders. Taxing residents' worldwide consumption could infringe on the tax bases of other nations if Singapore residents traveling abroad purchase a digitized good over the Internet instead of purchasing the same item from a store in the country to which they have traveled. Also, it may infringe upon customers' privacy to require them to provide residency declarations. In other words, the residency declaration requirement is neither tax efficient nor effective and fair to e-vendor, customer, and possibly even other economies.

Singapore's GST regime presents other issues, which may become problems. Most significantly, there is a concern that compliance costs will rise significantly and encourage noncompliance, as other countries begin to tax e-commerce consumption at different rates and under different regimes.[156] Finally, requiring e-vendors of digitized products to mail physical copies of invoices to customers and to include GST in the prices displayed on the Internet, unless approval is obtained to do otherwise, may slow the growth of e-commerce.

Hence, provided the IRAS will tax domestic consumption of digitized products purchased from foreign e-vendors, Singapore's GST regime for e-commerce transactions of digitized goods generally embodies the broad taxation principles and framework elements that the OECD recommends should apply to an e-commerce consumption tax. However, only time will prove its efficacy. Singapore's GST causes double-taxation and cost concerns for certain U.S. e-vendors of digitized products. Until the international community negotiates how e-commerce transactions of digitized goods and services should be taxed, the United States and Singapore should conclude a bilateral tax treaty to prevent double-taxing U.S. e-vendors of digitized products. The IRAS should also monitor the economic consequences of the GST registration threshold and consumer residency requirements.

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156 Maguire, *supra* note 7, at 29.

E. *The U.S. and Singapore Governments Should Conclude a Bilateral Tax Treaty to Address Double-Taxation Concerns, and the IRAS Should Clarify When Transactions Involving Digitized Products Will Result in Royalty Income*

Like the GST, Singapore's income tax treatment of international e-commerce transactions of digitized products endeavors to be neutral, efficient, clear and simple, and effective and fair. The IRAS will apply the "operations test" to e-commerce transactions to determine whether income is derived in Singapore and subject to Singapore income tax.[157] This approach reflects the OECD's recommendation that countries look to the core or essential business activities of the foreign e-vendor to determine tax jurisdiction (i.e., the "essential business activities" test).[158] The IRAS has taken the additional step of clarifying particular instances and situations in which foreign e-vendors of digitized products will meet the "operations test" and will be subject to Singapore income tax.[159] Since the "operations test" also applies to traditional commercial exchanges of physical goods,[160] these policies preserve tax neutrality by treating the modes of a transaction (i.e., e-commerce vs. traditional commerce) and the product forms (i.e., intangible vs. tangible) the same for tax purposes.[161] Also, by applying well-established rules to the tax treatment of e-commerce and by providing written regulatory guidance,[162] Singapore's income tax policy promotes efficiency, clarity, and simplicity. Finally, Singapore's income tax regime minimizes tax avoidance for foreign e-vendors of digitized products that do not have a permanent establishment or business operations in Singapore because such e-vendors will generally not be subject to Singapore income tax.[163]

Singapore's income tax on e-commerce raises some additional double-taxation concerns. U.S. e-vendors of digitized products may have to pay both U.S. income tax and Singapore withholding tax on the same income derived from sales in Singapore if the IRAS determines that payments allowing a customer to electronically download digitized products

[157] *See supra* notes 130-31and accompanying text.

[158] *See supra* notes 90-92 and accompanying text.

[159] INCOME TAX GUIDE, *supra* note 6, at 3-9, paras. 4-9.

[160] *Id.* at 1, para. 2.1.3.

[161] Each business model described in paragraphs 4-9 account for both tangible and intangible products. *See id.* at 3-9, paras. 4-9.

[162] *See generally* INCOME TAX GUIDE *supra* note 6; GST GUIDE, *supra* note 6.

[163] INCOME TAX GUIDE, *supra* note 6, at 5-8, paras. 7-8.

are income from the use of copyright by the customer.[164] Generally, U.S. companies deriving revenue from foreign sources are able to claim federal income tax credit only for "foreign-source income."[165] If the United States characterizes revenue from the sale of digitized products as income from the sale of inventory, for example, and Singapore characterizes such revenue as royalty payments, a U.S. e-vendor, like MusicNow.com in the example above, would pay both U.S. income tax and the fifteen percent Singapore withholding tax, for which it would get U.S. income tax credit for fifty percent of it at best.[166] Thus, at least half of the fifteen percent Singapore tax withheld on the transaction will be double-taxed. As in the case of the double-taxation specter raised by Singapore's GST tax, a U.S.-Singapore bilateral tax treaty could smite this concern under Singapore's e-commerce income tax regime.[167]

Alternatively, the IRAS could clarify that revenue derived from e-commerce transactions of intangible products will not automatically be characterized as royalty payments that are subject to withholding tax. The IRAS could adopt a standard similar to the "essential consideration" test recommended by the OECD[168] to determine the types of e-commerce transactions that will give rise to royalty income. Characterizing income according to the essential consideration for the purchase promotes tax neutrality. For instance, purchasing a CD in a store or online is not considered a royalty payment subject to withholding tax, even though the purchaser could easily copy the copyrighted works on the CD and resell it. Such a purchaser may be sued for violating the copyright, but the store that sold the CD would not have to pay a withholding tax on the sale. The tax treatment of digitized product purchases should be no different; otherwise, the tax regime would artificially favor one transaction form that involves one

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[164] The IRAS fully realizes that double-taxation may occur. *See* INCOME TAX GUIDE, *supra* note 6, at 2, 9, paras. 3.4.1, 10.

[165] *See* Maguire, *supra* note 7, at 27; 26 U.S.C. § 901 (1994 & Supp. 1999).

[166] *See* Maguire, *supra* note 7, at 27. If the transaction is treated as a sale of inventory, fifty percent of the income will be attributed to production activity and fifty percent will be attributed to sales activity. Treas. Reg. § 1.863-3(b) (1996). In the case of a U.S. e-vendor selling abroad, the fifty percent of income attributed to production activity will be sourced in the United States and the fifty percent of income attributed to sales will depend on where the sale is deemed to occur. Treas. Reg. §§ 1.863-3(c)(1), (2) (1996) and 1.861-7(c) (1960). If the sale is deemed to occur in the foreign country, then only fifty percent of the income derived from that transaction will be foreign-sourced and therefore, eligible for the foreign tax credit. Note that if the sale is deemed to occur in the United States, then none of the income will creditable under the foreign tax credit, and all of it will be double-taxed. Also, double-taxation will not occur with respect to transactions of the four categories of software that the IRAS has expressly exempted from the royalty income withholding tax. *See supra* note 139 and accompanying text.

[167] Inland Revenue Authority of Singapore, *Income Tax Guide on E-Commerce*, 3d ed., Feb. 23, 2001, para. 10.1.1 (visited Feb. 23, 2001), http://www.iras.gov.sg/Ec/Ec_frame.htm.

[168] *See supra* notes 85-89 and accompanying text.

form of a product over another transaction form that involves the exact same product in a different form.[169] Unless a government believes a non-neutral tax policy would enhance social welfare, it should avoid introducing economic distortions into the marketplace that could potentially discourage economic development. The IRAS should consider articulating a policy similar to the OECD's "essential consideration" test to clarify that it will apply the withholding tax to e-commerce sales of digitized products in a way that promotes the tax neutrality principle.

Thus, under Singapore's income tax regime, foreign e-vendors of intangible products that do not have a branch in Singapore or remit income to Singapore should not have to pay Singapore income tax on revenue earned from transactions with Singapore customers. However, depending on how the IRAS characterizes payments for digitized products and whether a bilateral tax treaty exists between Singapore and the resident state, e-vendors of digitized products may have to pay a Singapore withholding tax, which may not be fully creditable under the tax regime of the country of which they are a resident. Therefore, in the absence of these remedial steps, some income may be subject to double-taxation.

VI. CONCLUSION

Unlike international trade in other forms of products, the current e-commerce architecture allows cross-border e-commerce transactions of digitized products to escape existing taxes levied by the state where the product is consumed or the income is raised. E-vendors of digitized products only pay taxes to the state of which they are residents. The problem with not taxing international e-commerce sales of digitized products is that the tax bases of source countries likely will shrink, as these transactions comprise an increasing portion of the total volume of international trade.

While other countries attempt to search for and negotiate a solution to this potentially significant concern, the IRAS has taken a bold and proactive approach and published two documents describing how it intends to tax consumption and income derived from e-commerce transactions. Studying Singapore's proposed e-commerce tax regime is important because it is a model from which other countries—both those with similar tax regimes, such as E.U. member countries, and those that trade with them, like the United States—may learn.

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[169] *See supra* note 50 and accompanying text.

The IRAS proposal extends Singapore's existing GST and income tax policies to e-commerce. Provided the IRAS will tax domestic consumption of digitized products purchased from foreign e-vendors, these policies generally adhere to the internationally accepted tax principles of neutrality, efficiency, clarity and simplicity, effectiveness and fairness, and flexibility. However, given the current architecture of the Internet and the fact that Singapore is the lone e-commerce tax island in a tax-free e-commerce sea, these provisions also raise concerns of exposing foreign e-vendors of digitized products to double-taxation, overly burdensome compliance costs, and unequal tax treatment both between small- and medium-sized e-vendors and larger competitors, and between e-vendors and their brick-and-mortar competitors. Because most e-vendors of digitized products reside in the United States, and because the United States and Singapore have not negotiated a bilateral tax treaty, these issues impact U.S. e-vendors most. Proper responses must address these problems, especially as the revenue authorities of other economies begin to apply and enforce their tax policies on e-commerce.

Double-taxation concerns can be alleviated easily. The governments of the United States and Singapore could conclude a bilateral tax treaty to harmonize their tax policies on trade between the two countries. Also, the IRAS should adopt a policy similar to the OECD's "essential consideration" test as the standard to distinguish ordinary income from royalty income.

More creative international solutions are required to address the need to determine where a customer resides and the burden on the foreign e-vendor to know at the point of sale what tax to charge and remit. Unsolved, the magnitude of these problems may encourage noncompliance by foreign e-vendors of digitized products. Such noncompliance may be so widespread as to disable Singapore's e-commerce tax policy from capturing the revenue it seeks. The IRAS should carefully monitor the economic consequences of the S$1 million GST registration threshold, the policy of basing tax jurisdiction on where the customer purports to reside or on the consumer's domain name or IP address, and the requirements on e-vendors to obtain residency declarations from its customers and collect and remit GST. While technological solutions may arise, Singapore should share its e-commerce tax ideas and experiences with the international community, in particular the OECD member economies, to negotiate e-commerce tax protocols to strengthen its e-commerce tax regime. If the IRAS is able to collect the right amount of revenue at the right time from e-commerce without undue economic burden, other countries will emulate it and similarly preserve their tax bases.