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TARIFFS, TAXES AND ELECTRONIC COMMERCE: REVENUE IMPLICATIONS FOR DEVELOPING COUNTRIES

by

Susanne Teltscher

UNCTAD
Palais des Nations
1211 Geneva 10, Switzerland
susan.teltscher@unctad.org

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ABSTRACT

Cross-border electronic commerce is currently operating in a tax- and tariff-free environment. This, combined with predictions of steep increases of e-commerce during the next five years, has prompted Governments and tax authorities to discuss modifications to existing legislation that take account of these developments. One of their concerns is the potential loss in tax and tariff revenues resulting from e-commerce, which account for significant shares of government budgets in most countries. This is of particular concern to developing countries, where import duties comprise higher shares of government revenue and a shift to other revenue sources is economically less feasible. The paper presents data on potential revenue losses from import duties on a number of products that have been traded physically in the past but are increasingly being imported digitally. Findings show that developing countries will be the main losers as far as import duties from e-commerce products are concerned, while both developing and developed countries would suffer major revenue cuts from lost consumption taxes.

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INTRODUCTION

The most debated topic in electronic commerce at the present time, both among policy makers and the business community, is whether and how to collect tariffs and taxes on cross-border electronic commerce (e-commerce). So far, no national or international legislation has been put in place. At the same time, a steep increase in e-commerce during the next decade is predicted: the Organisation for Economic Co-operation and Development (OECD) estimates that it may reach a value of US$ 330 billion by 2001–2002 and US$ 1 trillion by 2003–2005 (OECD, 1999b). According to Forrester Research estimates, business-to-business e-commerce accounted for US$ 150 billion in 1999. This is expected to reach over US$ 3 trillion by 2004 (The Economist, 2000b). Hence, there is legitimate concern by Governments, especially in the developing countries, over the potential erosion of their tax base resulting from e-commerce if domestic and international rules are not modified to take account of these developments.

Data on government finance statistics support this concern (Table 1 and Figure 1). They show that taxes are the principal source of government revenue, accounting on average for about 80 per cent of total revenue (all countries). Domestic taxation of goods and services makes up the largest share in tax revenues (36.5 per cent).[1] Revenues from import duties account on average for 13.2 per cent of total revenue and 17.5 per cent of tax revenue. Major differences exist between developing and developed countries: for the former, import duties as a share of total government revenue are 15.8 per cent (compared with 2.6 per cent for developed countries) and as a share of tax revenue 21.2 per cent (compared with 3 per cent for developed countries).[2] The combined tax revenues from goods and services and those from imports account for 54 per cent of tax revenues (all countries), or 58.3 per cent of developing countries' and 37 per cent of developed countries' tax revenue. Hence, they make up a major source of government revenue in most countries.[3]

How will these revenues be affected by e-commerce? Will the increase in digital trade substantially reduce revenues from import duties and taxation of domestic goods and services? Should e-commerce therefore be subject to border tariffs and taxes?

The question of whether to levy tariffs on cross-border e-commerce has been taken up by the World Trade Organization (WTO). In 1998, WTO member States agreed to a two-year customs duties moratorium on "electronic transmissions". A decision on whether to extend the moratorium should have been taken at the Third WTO Ministerial Meeting[4] but has been postponed.

The broader subject of Internet taxation has been taken up by other forums. A number of proposals are currently being prepared by the OECD, the European Union and the United States for harmonizing taxation rules on international e-commerce and thus prevent potential fiscal losses that could result from a rapidly growing number of

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[1] Mainly sales and value added taxes.

[2] In the case of the European Union, individual member countries do not report revenues from import duties (some report very low values). This is because EU import duties are directly passed on to the EU common budget as a traditional own resources payment, and only 10 per cent is retained by the importing country (this share will be increased to 25 per cent as of 2001). Therefore, the calculations of EU member States' import revenues are based on their individual contributions to the EU budget (European Commission, 1998).

[3] Other important sources not considered here are income taxes and social security contributions.

[4] The Third WTO Ministerial Meeting was held in Seattle from 30 November to 1 December 1999.

international on-line suppliers, whose cross-border transactions will be subject to import and domestic taxes.

Developing countries are largely left out of these debates. Within the WTO, they have raised concerns about possible tariff revenue implications resulting from a ban on customs duties on electronic transmissions. However, they lack resources to provide evidence which could support their concerns. Many of them are still struggling to keep up with the rapid developments in the area of e-commerce, recognizing that it has the potential for substantial beneficial effects on their economies.[5] The taxation debate is very much dominated by the OECD countries, which have little concern for developing countries' interests, given the latter's small share in e-commerce. However, developing countries could be much more affected by fiscal losses resulting from e-commerce in view of their greater dependence on tariffs and taxes as revenue sources for their national budgets.

This paper attempts to bring the developing countries' concerns into the debate on potential revenue implications of e-commerce by looking at both tariff and tax revenues. Section II provides a short overview of the discussion on border tariffs for e-commerce taking place in the WTO. Key to this debate are conceptual and regulatory aspects of imposing customs duties on electronic transmissions. Section III looks at Internet taxation issues such as consumption and income taxation. Section four moves to the empirical part of the paper. It first analyses, using trade and tariff revenue data, the potential economic impact if in fact digitizable products replace physically delivered goods. Particular attention is paid to the impact on developing countries. This is followed by an analysis of additional duties levied on imports (besides border tariffs), including domestic consumption taxes (section V). On this basis, possible revenue losses resulting from e-commerce, particularly in the developing countries, are shown.

[5] For a discussion on e-commerce and development, see ITU (1999).

I. IMPORT TARIFFS AND CLASSIFICATION OF E-COMMERCE

The Geneva Ministerial Declaration of May 1998 includes for the first time in GATT/WTO history a mandate for work in the area of e-commerce. It specifies two elements: first, a standstill agreement on the imposition of customs duties on electronic transmissions; and second, a General Council mandate to establish a work programme on global electronic commerce. Four WTO bodies (the Council for Trade in Services, the Council for Trade in Goods, the Council for Trade-Related Aspects of Intellectual Property Rights and the Committee for Trade and Development) were thus instructed to examine and report on different aspects of e-commerce.[6] Although member States decided that all aspects concerning the imposition of customs duties on e-commerce would be examined in the General Council, the four WTO bodies had to address customs duties when discussing the classification of e-commerce, or more specifically, of electronic transmissions. “Classification” broadly refers to the question of whether electronic transmissions, or products shipped electronically (instead of physically), should be characterized as goods, services, intellectual property or something else. It is thus an issue that cuts across the debates in all four bodies. So far, no agreement has been reached. In fact, the difficulty of finding an agreement on the classification question has held up progress in the work on e-commerce, especially in the Council for Trade in Goods.

The link between the classification issue and the ban on customs duties is simple: depending on how electronic transmissions are defined, different multilateral agreements apply. For example, if they were classified as goods, they would be subject to General Agreement on Tariffs and Trade (GATT) rules, which would make electronically shipped products dutiable. If they were classified as services, on the other hand, they would be subject to General Agreement on Trade in Services (GATS) rules, and the application of customs duties would be questionable. This, in turn, would have different implications for government revenues obtained from tariffs imposed on these goods. Several WTO member States have therefore suggested that a final decision on the extension of the customs ban be delayed until the classification issue has been solved. The following will take a closer look at the conceptual and regulatory issues related to the classification of e-commerce (and hence the imposition of border tariffs), and how existing multilateral rules address them.

A. Conceptual issues

In the Geneva Ministerial Declaration, Ministers “also declare that Members will continue their

[6] Since 1998, each body has held a number of meetings where Members discussed and made proposals on the issues relevant to the work programme. By the end of July 1999, each body had submitted a progress report to the General Council. These reports have been reviewed by

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