Gunfire meant to cut down a 21-year-old man in front of his pregnant wife is the focus of a new war in the middle of America. The battle is not fought on the battlefields of Iraq or Afghanistan, but on the streets of Ferguson, Missouri. The victims are those who have been killed by police officers, often in confrontations that lead to fatal outcomes.

The conflict has sparked protests and clashes between police and demonstrators, with some incidents resulting in injuries or property damage. The situation has raised questions about police tactics and accountability, and sparked debates about the role of law enforcement in society.

Despite the controversy, the U.S. remains committed to maintaining law and order. The government has taken steps to increase police training and oversight, and has pledged to provide additional resources to help communities deal with the escalating violence. However, the underlying issues that have contributed to the unrest remain unaddressed, and the conflict is unlikely to end anytime soon.

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**Consumption Tax Challenges of the Digital Era**

A consumption tax applies at the place of consumption. Widely used consumption taxes include the VAT, used in over 140 countries, and the sales and use tax, used in many states. However, the digital age has introduced new challenges to the traditional tax system. With the rise of e-commerce and online transactions, it becomes increasingly difficult to determine the point of consumption.

This has led to calls for the introduction of a consumer-based tax system, which would tax consumers rather than businesses. While such a system could provide a more equitable tax burden, it also poses challenges in terms of administration and enforcement. 

As the digital economy continues to grow, it is likely that consumption taxes will need to be adapted to ensure they remain fair and effective.
used by 45 of the U.S. states, plus the District of Columbia. These taxes originated in the industrial era and apply fairly well to consumption of tangible goods. Tangible goods are delivered to a single physical location and vendors can determine the location with relative ease.

In contrast, the delivery of digital goods and use of digital services pose numerous challenges in application of consumption taxes. No physical address is needed for delivery of a digital good, such as a digital file of music or a novel. While the vendor can ask customers for their address, the vendor cannot necessarily verify that the address is correct. For example, a customer’s address associated with a credit card might not be where the customer resides. Also, certain payment schemes may not require the customer’s address (such as for payment via virtual currency).

Technology can enable vendors to learn the location of a customer. For example, cell phone and Internet access providers can determine where a person is when they use their cell phone, or log into a website or application to purchase a game, song, book or other digital item or to use a digital service. This information though, is not necessarily readily available to all vendors. Also, customers might make a digital purchase when convenient to do so at one location (such as waiting at the airport or sitting in a coffee shop or hotel room), but use it at another location (their home or office). Thus, the location determined via use of technology may not be the true place of consumption. Of course, this is also the case with some purchases of tangible goods, such as the purchase of clothes by a tourist in Los Angeles who lives in San Jose. Sales tax rules generally assume that the place of consumption is the place of physical delivery (the department store, for example). The same rule or assumption can be applied to digital goods and services. Alternatively, the customer’s address of residence can be the default.

Another location issue with digital goods and services that does not exist for physical goods is that digital goods and services might be used in multiple locations. For example, in a cloud computing transaction, a business customer might have employees in multiple locations accessing the vendor’s servers to use the software.

**BEPS Relevance**

In 2013, at the request of the G20 Finance Ministers, the OECD began work on a project known as “BEPS,” which stands for a tax concern described as “base erosion and profit shifting.” The G20 governments are concerned that mobility of capital, and the growth of multinational business activities and the digital economy, make it easy for some companies to move profits from the location of business activity to low- or no-tax jurisdictions. An action plan was launched by the OECD in July 2013. As described by the OECD, this “plan recognizes the importance of addressing the borderless digital economy, and will develop a new set of standards to prevent double non-taxation.”

While the focus of the BEPS Action Plan is income tax, VAT issues have also been noted. A BEPS-related report released by the OECD in September 2014, *Addressing the Tax Challenges of the Digital Economy,* notes two key challenges for VAT systems:

1. **Imports of low-value physical goods via e-commerce which many jurisdictions treat as exempt from VAT due to the administrative costs relative to the tax potential.** Typically, VAT is collected on a cross-border sale of tangible goods at the customs office. For low-cost items, a vendor might structure its operations to enable the purchase of such goods by customers in the vendor’s jurisdiction to be shipped from the vendor’s facility outside of the jurisdiction to qualify for the low-cost import exemption.

2. **The “strong growth” in the cross-border B2C market of digital goods and services with reduced or no VAT charged due to the complexity of enforcing VAT on these transactions.** The OECD observes that some countries allow these sales to be taxed to the vendor’s jurisdiction (origin sourcing) or at the rate of the origin (rather than destination), rather than the standard destination sourcing (the customer’s location and rate).

The OECD’s digital economy report observes that policy and administrative challenges exist in trying to resolve the two issues described above. For example, e-commerce allows for sales from vendors not present in a jurisdiction. The jurisdiction may have no legal authority or mechanism to have the non-present vendor register for VAT collection. For B2C transactions, it is difficult to have the consumer self-assess VAT. With digital goods and services, the challenges of even knowing that a transaction occurred makes a tax collection solution even more challenging to implement. Thus, competitive pressures arise where customers may prefer to buy from non-resident vendors who are not imposing VAT. A similar challenge exists in the U.S. with states trying to collect sales and use tax on e-commerce sales of both physical and digital goods from vendors that are not physically present in the state.

**Electronic Services**

Electronic services or electronically supplied services are those that involve the Internet or that require an electronic network to exist. These services involve “minimal human intervention.” Digital goods, such as software, games, music and films, are included. Also, web hosting and electronic databases are included. Electronic services do not include sale of physical goods via e-commerce.
Pre-2015 E.U. Approach Since 2003, the E.U. has used a hybrid system for applying VAT to B2C sales of electronic services. E.U.-established vendors impose VAT on these sales using an origin approach (place of the supplier), while non-E.U. vendors use the destination approach (where the customer resides). A simplified VAT collection scheme exists for non-E.U. vendors (those not registered for VAT in any E.U. country or established in the E.U.). Under this scheme, the non-E.U. vendor may register in one E.U. country and file a VAT return only in that country. The vendor charges VAT per the customer’s country, but reports and remits to the one country where it is registered. That country distributes the VAT to the appropriate countries, as indicated on the vendor’s return. Alternatively, the non-E.U. vendor can register in each country where it has non-business customers and file returns in those countries. The option to use the single country of registration approach allows the non-E.U. vendor reduced compliance obligations by avoiding quarterly filings in each country where it has customers. Generally, a reverse charge mechanism is used for B2B sales meaning that the business customer accounts for the VAT on the transaction rather than the vendor.

The hybrid sourcing approach violates the neutrality and economic efficiency tax principles because it provides competitive advantages to E.U.-vendors established in a low-rate country. The system also incentivizes non-E.U. vendors to establish an E.U. entity in a low-tax country, such as Luxembourg, to enable a single, low rate of VAT to be charged.

New E.U. Approach and the MOSS Starting in 2015, the E.U. VAT system for telecommunications, broadcasting and electronic services changes. All vendors will need to collect VAT on B2C sales to E.U. customers using the destination approach. Per explanation from the European Commission, for a B2C sale of electronic services to an E.U. consumer, the vendor charges VAT in the E.U. country “where the customer belongs” meaning “where they are registered, have their permanent address or usually live”.

The challenges of dealing with sourcing of electronic services will affect all vendors with E.U. non-business customers. Unlike physical goods that can be easily tracked, digital goods can pose challenges. The E.U. rules explain how to determine the destination country. Evidence may include the customer’s billing address, the Internet Protocol (IP) address of the device per a geolocation method, location of the bank account used for payment, the country code stored on a Subscriber Identity Module (SIM) card the customer used to obtain the e-services, the location of a land line phone if that was used, or “other commercially relevant information.” Special rules exist to cover download of digital goods away from home, aboard a transport and other specified situations. Similar to sourcing rules for sales of other than tangible personal property for state income tax purposes or sales tax, the rules are fairly complex.

The new rules provide simplification schemes for both E.U. and non-E.U. established vendors. This system is referred to as “mini One Stop Shop” or “MOSS.” Like the system that has been available to non-E.U. vendors prior to 2015, MOSS allows the vendor to use one country for compliance with VAT charged on B2C sales of electronic services (as well as telecommunications and broadcasting). A new feature is the “Union scheme” that allows an E.U.-vendor to use a MOSS for compliance with B2C eligible sales to E.U. countries where it is not established, but has non-business customers.

The “non-Union scheme” is similar to the existing (pre-2015) One Stop Shop, which is replaced by the MOSS starting in 2015. A MOSS is only for B2C sales of electronic services, telecommunications and broadcasting. The simplification for vendors using a MOSS is that it reduces the number of quarterly returns that must be filed for the eligible sales. Yet, returns are required for other taxable sales. Thus, the MOSS is likely most attractive to non-E.U. vendors that only have eligible sales.

E.U. countries offering a MOSS use a secure Web portal for its administration. Registered businesses electronically submit information and payment quarterly. The MOSS country (Member State of Identification) shares the information and revenues electronically with the Member States of Consumption. The information submitted through the MOSS process can be accurately interpreted, VAT Info Sheet 04/03, April 2003; http://webarchive.nationalarchives.gov.uk/20110202144320/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_PublicNoticesAndInfoSheets&propertyType=document&columns=1&id=HMCE_CL_000907.


10 For an explanation of the sourcing rules, see EC, Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015, 4/3/14; http://ec.europa.eu/taxation_customs/resources/documents/taxation_vat/how_vat_works/telecom/explanatory_notes_2015_en.pdf. Also see Irish Tax and Customs, Telecommunications, Broadcasting and Electronic (TBE) services (B2C) – New VAT Place of supply rules – 2015; http://www.revenue.ie/en/tax/vat/leaflets/place-supply-rules.html. These documents include links to the relevant EC guidance.
cessed by the revenue authorities of any E.U. country. MOSS registration started on Oct. 1, 2014.12

Relevance of E.U. VAT Changes for U.S.

E-commerce challenges sales and use tax collection in U.S. states in several ways. First, e-commerce makes it easy for a vendor to have a physical location in one or a few states, yet have customers in all states. Per the sales tax nexus rule established by the U.S. Supreme Court in 1992, a state may only impose sales tax collection obligations on a vendor if they have a physical presence in the state.13 Thus, states must increasingly rely on resident customers to self-assess use tax on their purchases from non-resident vendors.

Second, digital goods and electronic services pose similar challenges as in the E.U. One significant difference though is that many states, such as California, do not impose sales tax on intangibles and most services. Yet, this is likely to continue to change as states see their sales tax base erode when physical goods, such as books and software and music on a CD, are converted to digital items. Also, for fairness and neutrality purposes, states may modify their laws to impose sales tax on the digital equivalent of taxed physical goods.14 As states broaden their sales tax bases to include digital products, the rules among the states are unlikely to be consistent as to what digital products are taxed, how they are defined, and how the sourcing rules operate (unless the state follows the SSUTA, explained next).

Over 20 states have joined the Streamlined Sales and Use Tax Agreement (SSUTA) to have a uniform sales tax law that simplifies compliance for vendors. The SSUTA also includes software and third party collection options to further simplify compliance for vendors. The state-approved software offers immunity for errors if the software is used.15

Since the early 1990s, Congress has proposed changes to the physical presence nexus standard to enable states to collect sales tax from non-present vendors. This legislation, usually labeled as the Marketplace Fairness Act, requires states to implement specified simplifications to their sales tax laws. These proposals usually exempt small vendors and provide a basic sourcing rule.16

Does the E.U. sourcing and MOSS option for electronic services offer ideas for simplified and improved compliance for sales and use taxes? Next, key features of the new E.U. system are evaluated in terms of application to U.S. state sales and use taxes to answer this question.

Nexus: The concept of nexus that is relevant for vendors to know if they are subject to sales tax collection in any state, is not used in the E.U. A similar concept of “establishment,” is relevant in the E.U. Establishment for the vendor, though, mostly affects filing approach, not for knowing whether a vendor has a VAT collection obligation. For example, if a vendor is established in an E.U. country, it may avail itself of the “Union scheme” for MOSS, not the “non-Union scheme.” As long as the vendor has a B2C e-services sale in the E.U., it is subject to VAT collection, whether established in the E.U. or not. In the U.S., Congress would need to enact legislation, such as S. 743 (113rd Congress), to allow states to impose collection obligations on all vendors in order to achieve the ability E.U. countries have to impose VAT collection obligations on non-present vendors.

Uniform Sourcing: The E.U. governance system allows for uniform sourcing rules for sales in all E.U. countries. In the U.S., sourcing rules are established at the state level and may not be consistent among states. While S. 743 includes a sourcing rule, it will not lead to uniformity among states. This bill provides a general sourcing rule for non-SSUTA states and specifies that SSUTA states follow the sourcing rules of the SSUTA. S. 743 does not specify whether any federal agency has authority to issue regulations to further clarify the sourcing provision. Also, there is no specification as to how any disputes regarding interpretation of S. 743 are to be addressed, leading to the possibility of conflicting judicial decisions among states. The four-sentence sourcing rule of S. 74317 is unlikely to lead to certainty or uniformity due to the numerous ways that a customer may obtain electronic services (including digital goods).

A uniform set of sourcing rules applicable in all states would make compliance simpler for vendors and avoid double taxation for consumers. If such a system were designed among states or by Congress, considerations of the E.U. rules should be considered to simplify compliance for vendors with a global customer base.

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12 For the many details of the MOSS, see EC, Guide to the VAT mini One Stop Shop, 10/23/14; http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/telecom/one-stop-shop-guidelines_en.pdf. Information on the MOSS of the E.U. countries establishing them, such as Ireland, Spain, the UK, and others can be found at the tax agency websites.
14 For example, in 2006, New Jersey changed its law to start imposing sales tax on certain “digital property” such as music and books (see Tax Notes – Digital Property (06/28/07) at http://www.state.nj.us/treasury/taxation/digitalproperty.shtml). In 2014, Minnesota changed its law to start taxing specified digital products (see Sales Tax 177 at http://www.revenue.state.mn.us/businesses/sut/factsheets/FS177.pdf). Several other examples exist as well and many states tax off-the-shelf software whether acquired on tangible media or digital download.
15 The SSUTA and member state information can be found at http://www.streamlinedsaletax.org/.
16 For example, see S. 743 (113rd Congress), passed by the Senate in May 2013. For information on proposals of prior ses-
• **No De Minimis Rule:** The E.U. rules for B2C electronic sales apply to all vendors regardless of size. In contrast, S. 743 and its predecessors, include an exception for small vendors. For example, S. 743 provides:

> “Small Seller Exception- A State is authorized to require a remote seller to collect sales and use taxes under this Act only if the remote seller has gross annual receipts in total remote sales in the United States in the preceding calendar year exceeding $1,000,000. For purposes of determining whether the threshold in this section is met, the gross annual receipts from remote sales of 2 or more persons shall be aggregated if—

1. such persons are related to the remote seller within the meaning of subsections (b) and (c) of section 267 or section 707(b)(1) of the Internal Revenue Code of 1986; or

2. such persons have 1 or more ownership relationships and such relationships were designed with a principal purpose of avoiding the application of these rules.”

Possibly no small seller exception is included in the E.U. rules due to the MOSS simplifications (and the desire to collect the VAT on all B2C sales). However, while MOSS reduces the number of returns to file, vendors must still have systems in place to properly assess VAT on each B2C customer and properly report it in the MOSS system. Uniform sourcing rules and a combined filing option (MOSS) help reduce complexity, but there are still costs and compliance challenges for vendors of all sizes.

Congressman Goodlatte, chair of the House Judiciary Committee with jurisdiction over S. 743, has stated that any remote sales tax proposal should be simple enough that a small business exemption is not needed. The E.U.’s uniform sourcing rules and MOSS systems are some of several ideas that should be considered to achieve Congressman Goodlatte’s simplification goal.

• **Reverse Charge Mechanism:** Another simplification for vendors in the E.U. VAT rules for electronic services is that vendors do not need to charge VAT to business customers. Of course, the vendor still needs to determine if the customer is a business or consumer, but that is relatively easy as a business should be registered in the VAT system. In contrast, state sales tax laws require vendors to collect on all taxable sales, regardless of the type of customer. If a customer is entitled to an exemption, such as a resale exemption, the vendor is responsible for verification of such entitlement. This places increased compliance costs on the vendor to understand the various exemptions a customer may be subject to and maintain proper records to support why sales tax was not collected. Vendors also have the risk of having

> A reverse charge mechanism would simplify sales tax collection for U.S. vendors. While businesses would need to track all of their purchases, including the location of use and whether any exemption applies, this is already information the business readily has. Also, businesses are already required to track this information because where sales tax was not charged on a taxable purchase, such as because the seller did not have nexus in the state, the business must be able to self-assess use tax. While many businesses are not required to file sales tax returns, such as many service providers, they are required to file use tax returns. Thus, all businesses should already have a system in place of tracking purchases for sales and use tax purposes.

• **MOSS:** The MOSS simplifies compliance for vendors with few or no establishments in the E.U. Rather than making quarterly filings in each E.U. country with customers, the vendor only has to file in one country (although it must still apply destination sourcing to determine how much VAT to collect and for which jurisdiction). Additional simplifications of the MOSS include that it is optional, it avoids the need for currency conversions (a few E.U. countries do not use the Euro), and technology is used for ease of compliance and security. Also, the system is open to all E.U. tax agencies so vendors may find they have less contact with these agencies. The potential for more streamlined audits exists as well. One limitation of the MOSS is that it is only for the sales of telecommunications, broadcast and electronic services. Vendors still must file returns in countries where they have sales of other taxable items.

Technology-based compliance systems already exist in the U.S. The SSUTA includes an option for a “Certified Service Provider” which is a third party that handles much of the sales tax compliance for vendors. Another option is the use of approved software for determining and tracking sales tax obligations. These tools are also available to vendors in non-SSUTA states as private companies exist (such as the CSPs) that can provide systems integrated with a vendor’s sales system to simplify sales tax compliance. These solutions can be costly. State support of such systems improves the likelihood of their use (along with federal laws requiring their use).

A state tax agency Web portal for all filing obligations may prove advantageous for taxpayers, and some states have such systems for making and tracking payments. Where these systems can streamline filings among all jurisdictions and reduce recordkeeping, businesses should see additional advantages. Congress would likely need to step in to create such a system to ensure uniformity and to define how use of such a portal does not affect nexus determinations for any tax.

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18 S. 743 defines a remote seller as one that makes “remote sales.” Such sales are defined as ones where prior to the Act, the seller would not be required to collect sales tax (because it does not have a physical presence).


20 Some states may allow businesses to self assess sales tax rather than pay it to the vendor. For example, California has a direct payment permit system for certain sales. Under this system though, the vendor must still obtain an exemption certificate as proof that the customer had a direct payment permit. See Reg. 1699.5; http://www.boe.ca.gov/lawguides/business/current/btg/vol1/sutr/1699-5.html.

21 For considerations on whether to use a MOSS, see the EC Guide to the VAT mini One Stop Shop, which explains how the system works. Also see Rick Minor, Countdown to 2015: Top 10 E.U. VAT Changes for Suppliers of Digital Services, Tax Notes International, 769-773, 9/1/14.
Looking Forward

The start of the E.U.’s new/revised system for collecting VAT on B2C sales of electronic services will demand attention of many U.S.-based vendors as they consider moving from the current one-stop shop to a MOSS. Or, if they have not been compliant, they need to consider how to become compliant. Non-E.U. vendors are also likely to see changes in the E.U. marketplace for electronic services as all E.U. vendors adopt destination sourcing, which may result in higher prices for some customers, and business opportunities for other vendors.

If adopted in the U.S., some elements of the E.U. system for electronic services should enable simplified compliance for sales and use tax in the U.S. for all taxable items. For example, vendors would see simplifications if they only had to collect tax on sales to non-business customers. Uniform sourcing rules for all states would simplify compliance for vendors and avoid double taxation for customers.

As Congress continues to debate the Marketplace Fairness Act, consideration should be given to the new E.U. rules for electronic services and how it might benefit both states and vendors, as well as satisfy concerns of many members of Congress (which has delayed enactment of the legislation over the past twenty years). With few days remaining of the 113rd Congress, debate on the proposed Act will likely be pushed to the 114th Congress. That will provide a better opportunity to consider the E.U.’s MOSS and new sourcing rules that go into effect starting Jan. 1, 2015.