ENABLING EFFICIENT AND INCLUSIVE E-COMMERCE GOVERNANCE IN ASIA: A FOCUS ON DIGITAL TAXATION

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KEY TAKEAWAYS

- The current regulatory and economic environment highlights an important set of poorly recognised, competing challenges for e-commerce: firms are increasing their digital presence at the same time that stressed government budgets are targeting digital products and services with new tax policies.

- This is the case in Asia too, the world's fastest growing e-commerce market, where governments are erecting different types of taxation schemes on goods and services sold through e-commerce channels.

- Taxes on e-commerce in the region include digital permanent establishment rules, digital services taxes, consumption taxes like GST and VAT, and import duties on digital products.

- If not managed properly, e-commerce taxation policies can create knock-on effects that increase costs for actors down the value chain, such as micro, small and medium sized enterprises (MSMEs) that rely on e-commerce services to compete in foreign markets and that do not have the means to comply with complicated regulations across multiple markets.

- To date, there have been no regional governance structures that enable the development of inclusive e-commerce taxation policies across the region. To ensure that moving forward digital taxation policies do not endanger the growth of e-commerce, this paper brings forward the following guiding principles:

- **Manage the risks of corporate taxation approaches** by assessing the probable knock-on effects of policies on the broader e-commerce ecosystem – especially their potential to trigger significant price increases for e-commerce services.

- **Adopt an MSME-friendly and coordinated approach to consumption taxes** by streamlining the use of *de-minimis* thresholds and promoting the development of common approaches and standards for consumption taxes.

- **Avoid customs duties on digital products** by upholding the WTO moratorium on taxing electronic transactions, and work on regional initiatives to use non-discriminatory forms of taxation

INTRODUCTION

The cross-border exchange of goods and services over the internet has grown exponentially in the Asia-Pacific region, where the e-commerce sector has experienced the fastest growth in the world – the value of the region's e-commerce sector increased from US$ 5.5 billion in 2015 to US$ 38 billion in 2019 and is on track to exceed US$ 150 billion by 2025.[1]

The rapid development of e-commerce in the region has been a catalyst for the growth and internationalisation of micro, small and medium enterprises (MSMEs) spanning the Asia-Pacific. They account for an average of 96% of all enterprises and 62% of the national labour force across Asian countries.[2] Traditionally, MSME participation in international trade has been stymied by certification hurdles, high barriers to trade, information asymmetries and limited economies of scale. However, the proliferation of e-commerce marketplaces, market research tools and MSME-friendly finance and logistics solutions have reduced the logistics and marketing costs and barriers faced by MSMEs. Smaller businesses that successfully leverage digital tools can potentially reduce export costs by up to 40% for goods producers and 82% for service producers.[3] Such opportunities have enabled MSMEs to turn into "micro-multinationals" that rely on digital tools and innovation to develop internationally competitive goods and services.

Despite growing opportunities, the export performance of MSMEs in the region remains relatively poor. According to 2017 data, only 8.8% of MSMEs in the region sold goods and services outside their own market.[4]

There are several types of factors that limit MSME participation in cross-border e-commerce. Economic actors and conditions, such as ICT affordability and accessibility, availability of online

1 *Google & Temasek / Bain. 2019. "e-Conomy SEA 2019." 2019. (https://www.blog.google/documents/47/SEA_Internet_Economy_Report_2019.pdf). 32.*

2 *Yoshino, Naoyuki Yoshino and Farhad Taghizadeh-Hesary. 2019. "Role of SMEs in Asia and the Financing Challenges They Face." In Unlocking SME Finance in Asia, January 2019. (https://doi.org/10.4324/9780429401060-1). 1.*

3 *Asia Pacific MSME Trade Coalition (AMTC) and AlphaBeta. 2018. "Micro-Revolution: The New Stakeholders of Trade in APAC." AMTC, February 2018. (https://static1.squarespace.com/static/5393d501e4b0643446abd228/t/5a8ofe5a4192024c49bd9e0a/1518403194740/AMTCDigitalTradeFeb2018.PDF). 23.*

4 *Oxford Economics. 2017. "Local Business Global Ambition: How the Internet Is Fuelling SME Exports in Asia-Pacific." Oxford Economics, 5 June. (https://www.oxfordeconomics.com/my-oxford/projects/367780).*

payment options, and delivery of infrastructure are inconsistent across the region.[5] Multiple research projects have shown that legal and institutional environmental factors are instrumental in legitimising and facilitating cross-border e-commerce growth.[6] Regulatory institutions, bodies and rules have a direct impact on individual organisations' e-commerce behaviours by affecting the affordability, accessibility and growth of e-commerce activities.[7] For instance, country-specific regulations on market access, intermediary liability, copyright issues, and cross-border data restrictions can add significant costs to cross-border e-commerce.[8]

While firms have not traditionally worried about cross-border application of taxes on electronic commerce and digital services delivery, this situation is changing rapidly. Increasingly, governments are implementing taxation policies targeting e-commerce platforms and e-commerce sellers. This is possibly due to governments being concerned about the potential of e-commerce to erode tax revenue, since to date most e-commerce transactions have not been directly taxed.[9]

On one hand, some argue that e-commerce sales should be taxed since the tax revenues are likely to be substantial and failing to do so could create "unfair advantages" for e-commerce businesses over traditional brick and mortar establishments.[10] In the Asia-Pacific region, governments are starting to put in place different types of taxation schemes on goods and services sold through e-commerce channels. These include digital services taxes, goods and services taxes (GST), or customs duties on digital products.

5 *ADB and UN ESCAP. 2018. "Embracing the E-Commerce Revolution in Asia and the Pacific." Asian Development Bank. (https://doi.org/http://dx.doi.org/10.22617/TCS189409-2).*

6 *ADB and UN ESCAP. 2018. "Embracing the E-Commerce Revolution in Asia and the Pacific."; Asia Pacific MSME Trade Coalition (AMTC) and AlphaBeta. 2018. "Micro-Revolution: The New Stakeholders of Trade in APAC." Economic Research Institute for ASEAN and East Asia (ERIA). 2012. "Study on MSMEs Participation in the Digital Economy in ASEAN: Nurturing ASEAN MSMEs to Embrace Digital Adoption." (https://asean.org/storage/2012/05/ASEAN-MSME-Full-Report-Final.pdf).*

7 *ADB and UN ESCAP, "Embracing the E-Commerce Revolution in Asia and the Pacific." 13.*

8 *Asia Pacific MSME Trade Coalition (AMTC) and AlphaBeta. 2018. "Micro-Revolution: The New Stakeholders of Trade in APAC."; Economic Research Institute for ASEAN and East Asia (ERIA). 2012. "Study on MSMEs Participation in the Digital Economy in ASEAN: Nurturing ASEAN MSMEs to Embrace Digital Adoption."*

9 *Note that this paper is not grappling with the application of taxes to corporate revenues, which is the subject of heated debates in the OECD and elsewhere.*

10 *Simkin, Mark G., Graham W. Bartlett, and J. P. Shim. 2011. "Pros And Cons Of E-Commerce Taxation." International Business & Economics Research Journal (IBER) 1, 2. (https://doi.org/10.19030/iber.v1i2.3894).*

On the other hand, many scholars support the idea that the internet should be an international tax-free zone and that collecting and enforcing tax laws on the internet can be complex, inefficient, unwieldly and require substantial increases in government tax supervision and enforcement efforts.[11] The application of cross-border taxes will likely increase barriers to entry and limit trade, particularly for MSMEs that do not have the means and resources to comply with complicated regulations and administrative requirements.

Typically missing from discussions on taxation of e-commerce and digital trade are clear assessments of what taxation policies and different types of taxation arrangements may do to companies in the digital space. Most important, cross-border taxation suggestions have the potential to eliminate the "micro-multinational" and other small size sellers, vendors, and distributors that have thrived in the online environment.

This paper will conduct a careful analysis of approaches to e-commerce taxation in Asia. To do so, the paper first classifies and maps e-commerce taxation policies across 16[12] countries in Asia – the first comprehensive regulatory stock-take of taxation policies with implications for cross-border trade. Second, the paper leverages recent tax and economic literature to explore the ways in which specific types of taxation may affect e-commerce growth. Third, the paper assesses regional and multilateral governance structures covering e-commerce taxation policies. Last, based on the regulatory stocktake and the assessment of both the effects of e-commerce taxation policies and the effectiveness of existing governance structures, the paper suggests regulatory best practices less likely to hinder the development of new technologies or limit the participation of businesses in an evolving and growing e-commerce market. ■

11 *See, for example, Simkin, Mark G., Graham W. Bartlett, and J. P. Shim. 2011. "Pros And Cons Of E-Commerce Taxation."*

12 *The 10 members of ASEAN (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam) as well as Australia, China, India, Japan, Korea and New Zealand.*

E-COMMERCE TAXATION POLICIES IN THE ASIA-PACIFIC

Driven by the need to capture some of the value of a fast-growing e-commerce segment and level the playing field between brick-and-mortar sellers and e-commerce firms, countries across the region have begun to put into place taxes on online goods and service providers. This section provides a stocktake of different types of policies taxing cross-border digital goods and services across 16 countries in the Asia-Pacific.[13] Based on a growing set of literature on different e-commerce taxation policies and country-specific reports, *Table 1* shows a regulatory matrix that outlines and characterises taxation policies (implemented or proposed) across the selected countries.

While the definition and scope of digital taxation policies in the region varies significantly between countries, these can be classified into two categories: direct or indirect taxes on e-commerce.

13 *Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam, Australia, China, India, Japan, Korea and New Zealand.*

14 *This table was developed by consulting academic literature and reports outlining the design and implementation of different types of e-commerce taxation policies across the region. Relevant sources are cited on the columns of the table. The information from each of the sources was corroborated employing country specific and up-to date information.*

15 *Ezez. 2020. "Taxation of the digitalized economy (Development Summary)." KPMG. (https://tax.kpmg.us/content/dam/tax/en/pdfs/2020/digitalized-economy-taxation-developments-summary.pdf).*

Table 1: Regulatory Matrix: Ecommerce Taxation Policies in the Asia-Pacific[14]

No.	Country	TYPE OF TAX AND IMPLEMENTATION			
		DIRECT TAX[15]			
		Withholding Tax (WTH)	Digital Permanent Establishment (PE)	Equalisation Levy	Digital Service Tax (DST)
1	Australia				
2	Brunei				
3	Cambodia				
4	China				✓
5	India	✓	✓	✓	
6	Indonesia		✓		✓
7	Japan				
8	Lao PDR				
9	Malaysia	✓			
10	Myanmar				
11	New Zealand				●
12	Philippines				●
13	Singapore				
14	South Korea				✓
15	Thailand	●			●
16	Vietnam	✓			✓

Table 1 Key: Implemented Policy: ✓ Proposed Policy: ●

No.	Country	TYPE OF TAX AND IMPLEMENTATION			
		INDIRECT TAX			
		Consumption Tax[16]		Border Taxes	
		VAT	GST/Service tax	Duty Digital Products	De minimis threshold (USD)[17]
1	Australia		✓		$680 for duties. $0 for GST
2	Brunei	Electronic Transaction Tax			$291 for duties.
3	Cambodia				$50
4	China	✓ (VAT + Consumption Tax)			Shipments with duty and VAT liability less than $7
5	India		✓		$1 (Duty and GST exempt) and $14 (GST exempt)

Table 1 Key: Implemented Policy: ✓ Proposed Policy: ●

16 *PwC. 2019. "PwC Asia Pacific VAT/GST Guide 2019." PricewaterhouseCoopers (PwC) Indirect Taxes Network in Asia Pacific. (https://www.pwc.com/sg/en/tax/assets/vat-gst-guide-2019.pdf).*

17 *Ezez. 2020. "Overview of de minimis value regimes open to express shipments world-wide." Global Express Association (GEA). (https://global-express.org/assets/files/Customs%20Committee/de-minimis/GEA%20De%20Minimis%20Country%20information%20as%20of%2015%20October%202019.pdf). USD conversions are based on exchange rates dated 12 October, 2019*

No.	Country	TYPE OF TAX AND IMPLEMENTATION			
		INDIRECT TAX			
		Consumption Tax[16]		Border Taxes	
		VAT	GST/Service tax	Duty Digital Products	De minimis threshold (USD)[17]
6	Indonesia	✓ (VAT +Electronic Transaction Tax)		✓[18]	$3 for duties. $0 for VAT
7	Japan	Consumption Tax			$92
8	Lao PDR				
9	Malaysia		(Service Tax)		$119
10	Myanmar				$50
11	New Zealand		✓		$633
12	Philippines	●			$194
13	Singapore		✓		$291
14	South Korea	✓			$150 (personal shipments)
15	Thailand	●			$49
16	Vietnam	✓			$40

Table 1 Key: Implemented Policy: ✓ Proposed Policy: ●

18 *Medina, Ayman. 2020. "Indonesia's Law on E-Commerce: Clear Guidelines and Compliance by November 2021." ASEAN Business News. (https://www.aseanbriefing.com/news/indonesias-law-on-e-commerce-clear-guidelines-and-compliance-by-november-2021/).*

1. Direct Taxes on E-Commerce

Direct taxes are taxes paid by an individual or organisation directly to a tax authority. Based on different criteria, which may include the permanent establishment and residence of a business or the location of key sources of revenue, platforms and businesses facilitating e-commerce can be subject to direct taxes. To date, some governments in Asia have implemented a source-based approach to the direct taxation of e-commerce and internet platforms, which means they are taxed for the income earned in a country regardless of whether they are incorporated or physically present in that country.[19] Direct tax legislations on e-commerce platforms can be classified into six categories:

1/ **Gross-Based Withholding Tax on E-Commerce:** India, Malaysia, Thailand and Vietnam have put in place a withholding tax levied on payments for the sale of goods and services made to "non-resident" e-commerce businesses. An e-commerce operator subject to this type of tax is required to pay a percentage of the gross value of the sale of goods/services facilitated through its digital platform. In some countries, the withholding tax rate may vary depending on the place of residence of a particular business. For instance, in India the withholding tax levy increases from one to five percent if the e-commerce platform does not have an Indian income tax registration.[20]

2/ **Digital Permanent Establishment Rules:** The concept of Permanent Establishment (PE) allows a government to establish tax jurisdiction – often a corporate tax – over a foreign unincorporated business activities in its country. Recent virtual PE rules enable states to tax e-commerce providers with a "significant digital presence." Such a presence is often determined by taking into account activities like the use and sale of data, the online sales of goods and services and the housing of data servers.[21] India and Indonesia have in place this type of permanent establishment rule.

19 *Basu, Subhajit. 2003. "Taxation of E-Commerce from a Global Perspective." (https://core.ac.uk/download/pdf/78911849.pdf). 35.*

20 *Bhojwani, Prashant and Sandeep Bhalla. 2020. "India: Amending the Tax Framework to Move towards a Digital Economy." International Tax Review, 6 April. (https://www.internationaltaxreview.com/article/b1l2slw8nq6wzh/india-amending-the-tax-framework-to-move-towards-a-digital-economy).*

21 *Shield Geo. 2016. "How to Anticipate Virtual Permanent Establishment and International Tax in the Digital Age?" (https://shieldgeo.com/how-to-anticipate-virtual-permanent-establishment-and-international-tax-in-the-digital-age/).*

3/ Digital Services Taxes: Digital Services Tax (DST) is a tax on selected revenue streams attributed to the source country – the country in which an e-commerce provider generates its revenue. The types of revenues considered vary by state and can include revenues from online advertising, the provision of a digital interface, and the transmission of data collected about users for advertising purposes.[22] DST laws have been implemented in South Korea, Vietnam, Indonesia and China and have been proposed in New Zealand, Philippines and Thailand. DST directly affects advertising and intermediary activities that facilitate online sales of goods and services.

4/ Equalisation Levy: Specific to India, the equalisation levy is a levy applied at a rate of 6% to "specified services" that include online advertisement and any provision of digital advertisement space – a scope similar to the EU's DST. Moreover, India's 2020 Finance Bill expanded the scope of the levy to foreign e-commerce operators at a rate of 2%. The expanded levy applies to online sales of goods and provision of services provided by an e-commerce operator.[23]

2. Indirect Taxes on E-Commerce

Indirect taxes are levied on goods and services before they reach consumers, added to the market price the consumer pays, and then ultimately paid to the government. Indirect taxes affecting cross-border e-commerce can be divided into two broad groups: consumption taxes and import duties.

1/ Consumption taxes: Consumption taxes are indirect taxes levied on the selling price of goods and services consumed in a particular country, including both the supply and import of goods and services. These have been implemented as Value Added Taxes (VAT) or Goods and Services Taxes (GST) across multiple countries in the region. All countries in this review, with the exception of Cambodia, Lao PDR and Myanmar, have in place or have proposed

22 *Asen, Elke. 2020. "What European OECD Countries Are Doing about Digital Services Taxes." Tax Foundation, 22 June. (https://taxfoundation.org/digital-tax-europe-2020/).*

23 *KPMG. 2020. "India: Digital Taxation, Scope of 'Equalisation Levy." KPMG, 24 March. (https://home.kpmg/us/en/home/insights/2020/03/tnf-india-digital-taxation-enlarging-the-scope-of-equalisation-levy.html).*

a consumption tax that targets the online sale of cross-border goods and services. While the criteria vary between countries, most producers selling goods or services into a particular country with a VAT or GST must charge this tax from their end consumer. For example, in Singapore, the sale of physical goods and digitised goods like movies, e-books or software are all subject to a 7% GST.[24] In Indonesia, companies are charged a VAT on taxable intangible goods and services sold through electronic platforms.[25]

2/ **Import Duties on Digital Products:** Since the 1998 Geneva Ministerial Conference, WTO members have upheld a moratorium against tariffs or customs duties on electronic transmissions. The moratorium has been extended every two years at each WTO Ministerial Conference. To date, in Asia, only Indonesia has a legislation to levy import duties on digital products. In 2018, the country proposed to apply tariffs on electronically transmitted products at 0%, with the potential to increase the duty at any point.[26] This means that once the provision enters into force, any Indonesian company importing digital products or services will need to register for customs duty (tariff) payments.

3/ **De-Minimis Threshold:** The *de-minimis* rule refers to exceptions on consumption taxes and/or duty collection given to items valued below a certain threshold. If a shipment falls under the *de minimis* threshold of a country, it may be exempt from additional import taxes and duties. All countries in this review, with the exception of Lao PDR, have in place a *de-minimis* threshold for import duties and/or consumption taxes. Their coverage varies across the region. For instance, in countries like Australia the *de-minimis* threshold exempts importers from customs duties, but not from indirect consumption taxes. ■

24 *IRAS. 2020. "Goods and Services Tax (GST): What It Is and How It Works." (https://www.iras.gov.sg/IRASHome/GST/GST-registered-businesses/Learning-the-basics/Goods-and-Services-Tax--GST---What-It-Is-and-How-It-Works/).*

25 *Elokasari, Eisya. 2020. "Indonesia Taxes Tech Companies through New Regulation." The Jakarta Post, 1 April. (https://www.thejakartapost.com/news/2020/04/01/indonesia-taxes-tech-companies-through-new-regulation.html).*

26 *Officially, Indonesia opened up several tariff lines under HS Chapter 99 to include electronic delivery of books, music, software and "other digital products." See ISD. 2020. "The Future of WTO Moratorium on Duties on Electronic Transmissions: Why Shouldn't Border Control Be Implemented in the Internet Economy." ISD Indonesia, 23 January. (https://www.isd-indonesia.org/index.php/2020/01/23/the-future-of-wto-moratorium-on-duties-on-electronic-transmissions-why-shouldnt-border-control-be-implemented-in-the-Internet-economy/).*

The previous section highlighted the diverse approaches to the taxation of the digital economy. Whether through their effect on service providers, intermediaries, companies or users, direct and indirect taxation policies targeting cross-border online sales of goods and services increase costs for stakeholders in the regional e-commerce ecosystem. However, concerns about a potentially eroded tax base and unfair advantages for e-commerce businesses will continue to drive such policies across the region.

1. Direct Taxes on E-Commerce Platforms and Sellers

As shown in the previous section, countries in the region have leveraged Digital Permanent Establishment Rules and imposed Withholding and Digital Services taxes targeting the revenues of companies providing e-commerce-related services. Based on existing analysis, while most direct taxes imposed across the region target the revenues of companies facilitating the online sale of goods and services, if not managed properly, such policies could create knock-on effects that increase costs for other actors down the value chain – especially sellers leveraging or consumers using e-commerce platforms.

The proliferation of direct taxes on e-commerce companies has risen from the perception that digital companies are not paying "their fair share of tax."[27] Proponents of such direct taxes argue that without adjustment, tax policies no longer fit the modern context where businesses rely heavily on hard-to-value intangible assets, data and automation, all of which can enable trading without physical domestic presence.[28] Unilateral direct taxation approaches, like the DST and Digital Permanent Establishment Rules, allow governments to tax the revenue of foreign digital and e-commerce companies offering goods and services in their country. These models have been critically examined by existing literature on the basis of whether such approaches are adequately justified, follow principles

27 *Bauer, Matthias. 2018. "Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions." ECIPE. (https://ecipe.org/publications/digital-companies-and-their-fair-share-of-taxes/).*

28 *OECD. 2019. "Addressing the Tax Challenges of the Digitalisation of the Economy." (https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf).*

of 'fair taxation' or unjustifiably target revenue instead of profits. For instance, recent empirical analysis of the EU's DST has found that a tax on digital revenues stands against tax efficiency and neutrality principles and undermines EU policy priorities for the digital economy by: (i) affecting employment and tax revenues on digitally enabled companies and (ii) increasing the risk of reciprocal treatment against the EU services exports and subsidiaries, amounting to € 31 billion under a 3% turnover tax.[29]

What most of current analysis misses is the impact that increased costs for e-commerce platforms could have on e-commerce vendors, firms and the consumers using those platforms. In the absence of Digital Physical Establishment Rules and the taxation of digitally-generated revenues, emerging economies and MSMEs were able to develop and sell internationally competitive goods and services across the world. Therefore, changing cost structure to the current e-commerce ecosystem could increase the trade and compliance costs for e-commerce vendors and buyers and, as a result, limit their ability to develop price competitive products for foreign markets.

Different governments have different rules covering tax, but tax regimes typically require that sellers and vendors have domestic tax registration numbers for all businesses selling in the country or for those who anticipate sales above a certain threshold. Most MSMEs do not have tax ID numbers in all potential sales jurisdictions, nor can they anticipate ahead of time whether they are likely to exceed the threshold(s) for sales in a given year. Under some policies, it may be that all MSMEs either have to have tax IDs in foreign markets or that every platform registers all online sellers. If the costs to the platforms of registering sellers are high, the response of many platforms may be to restrict the carriage of MSMEs in foreign markets that are unlikely to sell many products. This will reinforce the critique that many foreign platforms are insufficiently supportive of MSMEs.

Under DST and Equalisation Levy laws, the costs of those taxes on digital advertisement, marketing and e-commerce platforms are

29 *Bauer, Matthias. 2018. "Digital Companies and Their Fair Share of Taxes: Myths and Misconceptions."; Lee-Makiyama, Hosuk. 2018. "The Cost of Fiscal Unilateralism: Potential Retaliation against the EU Digital Services Tax (DST)." ECIPE. (https://ecipe.org/wp-content/uploads/2018/11/The-Cost-of-fiscal-unilateralism-Potential-retaliation-against-the-EU-Digital-Services-Tax-DST-1.pdf).*

likely to flow down the supply chain in the form of higher costs for MSMEs and consumers.[30] Given the impact that these taxes will have on the profitability and cost structure of digital services companies and e-commerce platforms, it is likely that they will modify their pricing policies and pass a portion of the tax burden onto both business owners and consumers. For example, after the implementation of the DST in France, Amazon notified sellers in the French market that it would increase its referral fee rate to reflect additional costs of operating in the market.[31]

For businesses that rely on online advertisement and e-commerce services in such markets, these additional costs may affect operations. For example, consider the case of a Cambodia-based producer selling apparel in the Indian market through an e-commerce platform. As a result of withholding, permanent establishment and equalisation levy taxes, the vendor may see substantial cost increases to any digital advertisement, marketing and e-commerce services it uses to sell into India. Such an additional tax burden could force the producer to pass the cost down to consumers in order to commercially survive. But a higher product price could make its product much less competitive in a market where e-commerce imports are already subject to a GST consumption tax.

2. Reducing Barriers to Trade Created by Indirect Taxation

Governments and multilateral forums have recognised the need to impose indirect taxes on physical goods and services purchased from third countries. As shown in Section 3, most countries in the region have a VAT or GST tax in place, levied on import transactions of goods and services. If not approached carefully, the application of cross-border indirect taxes could increase barriers to entry and limit trade for MSMEs that do not have the means and resources to comply with complicated regulations and administrative requirements. Indirect tax policies must strike a balance between the need to collect taxes and ensuring that these processes are not overly

30 *Ecommerce Europe. 2018. "Factsheet – Taxation of the Digital Economy." (https://www.ecommerce-europe.eu/wp-content/uploads/2018/07/Ecommerce-Europe-Digital-Tax-Factsheet-2.pdf).*

31 *Bauer, Matthias. 2019. "Digital Services Taxes as Barriers to Trade." ECIPE. (https://ecipe.org/wp-content/uploads/2019/11/CaseStudy_DigitalService.pdf).*

complex nor discriminatory by creating non-tariff barriers – especially for MSMEs.

VAT and GST taxes both have a direct impact on MSMEs and can make compliance for non-residents, especially MSMEs, difficult in jurisdictions where they have no presence. Companies bear additional compliance costs to minimise the risk of incurring assessments and penalties that arise from the failure to properly register and pay VAT/GST, as this could have a significant impact on their e-commerce sales.[32] Moreover, potential obstacles to small businesses are compounded by a lack of standards and harmonisation across the region. Currently there is no clarity or agreement between countries about how tax should apply to e-commerce sales and who is responsible for charging; which may lead to double taxation.[33]

De-minimis rules offer an alternative for MSMEs that rely on low-value shipment cross-border e-commerce models. *De-minimis* thresholds can excuse low value shipments from customs import duties and GST/VAT consumption taxes, so that market entry barriers and compliance costs are significantly reduced and the delivery of low value e-commerce shipments is accelerated.[34] In addition, research has shown that *de-minimis* rules can simplify inspection procedures and enhance the efficiency of border crossing.[35]

However, as shown in Section 3, in the current regional environment, the value and scope of *de-minimis* thresholds vary widely across all countries. In some occasions they do not include GST/VAT consumption taxes, as shown in Australia and Indonesia, or are set so low that they effectively include the vast majority of e-commerce shipments, as in India or Indonesia (*Table 1*). As a result, an MSME that exports low value shipments to countries across the region must ensure that it complies with different indirect tax requirements and pays customs duties in each of its end markets. This can be prohibitive for most MSMEs,

32 *EY. 2016. "e-Commerce: Today's Indirect Tax Challenges." (https://www.ey.com/Publicationc/vwLUAssets/ey-indirect-tax-chapter-report-2./$FILE/ey-indirect-tax-chapter-report-2.pdf).*

33 *EY. 2016. "e-Commerce: Today's Indirect Tax Challenges."*

34 *United Nations ESCAP. 2019. "Selected Issues in Cross-Border e-Commerce Development in Asia and the Pacific." (https://www.unescap.org/publications/studies-trade-investment-and-innovation-no-91-selected-issues-cross-border-e-commerce).*

35 *United Nations ESCAP. 2019. "Selected Issues in Cross-Border e-Commerce Development in Asia and the Pacific."*

which do not have the resources, economies of scale or operating margins to develop internationally competitive products under multiple country-specific indirect taxation regimes. For instance, a year after China removed its *de-minimis* threshold, approximately 50 to 70% of cross-border e-commerce firms shut down, as a result of low cash flow and insufficient supply of popular imported goods.[36]

3. Eliminating Duties on Digital Products

As shown in Section 3, some governments in the region are also considering imposing customs duty tariffs on imported digital products. Supporters of these tariffs have argued that increasing volumes of electronic transmissions have replaced trade in physical goods, and therefore these countries are losing out in the form of foregone tariffs that can be recouped through a duty applied to electronic transmissions.[37] Such policies go against the WTO's current moratorium on electronic transactions, but can have a significant impact on sellers and buyers of digital products and the growth of the digital economy as a whole.

For sellers of digital products such as software, digital media and other types of digital services, who are already subject to GST/VAT indirect taxation, a customs duty on their products can further reduce their competitiveness and affect their ability to operate in multiple markets. After all, unlike consumption taxes, a customs duty on electronic transactions only affects the prices of imported digital products. If multiple countries in the region decide to impose this type of tariff, the impacts could be disastrous for emerging economies that rely on imports or exports of digital products and services.

For buyers of imported digital products, which often are MSMEs, the imposition of tariffs on those products can significantly increase their compliance costs and affect their productivity gains. Companies across the region often rely on imported software products, cloud services, digital advertisement, digital rights management (DRM) tools and other types of

36 *Yu, Sheila. 2017. "New Tax Regime Has Shaken up China's Cross-Border e-Commerce Sector." TechNode, 14 April. (https://technode.com/2017/04/14/new-tax-regime-has-shaken-up-chinas-cross-border-e-commerce-sector/).*

37 *Banga, Rashmi. 2019. "Growing Trade in Electronic Transmissions: Implications for the South, 2019." UNCTAD. (https://unctad.org/en/PublicationsLibrary/ser-rp-2019d1_en.pdf).*

digital products to increase their productivity.[38] MSMEs that leverage digital tools can save time required for export related tasks by up to 29%.[39] A customs duty on those products could affect their operations in the following ways:

1/ Even if the tariffs are at 0%, as it is the case under Indonesia's proposed scheme, they will still create additional administrative and compliance costs for businesses and consumers of digital products. Customs requirements for every electronic transmission would be incredibly difficult to comply with for most businesses, especially MSMEs.[40]

2/ If the tariffs are higher than 0%, they would restrict the ability of businesses, or at least make it more costly, to use imported digital products. Tariffs could limit the supply of digital products in a particular market, affect domestic output, increase domestic prices and the cost of private production.[41]

Moreover, tariffs on electronic transmissions could impose an undue administrative burden on not just producers and consumers but also on tax authorities and carriers. The identification and collection of duties on electronic transmissions is a costly, complex process that requires the development of new infrastructure to track and attribute commercial value to electronic transmissions.[42]

The imposition of duties on electronic transactions creates additional costs for sellers, buyers and tax authorities, as well as on leveraging digital tools as production inputs, that may outweigh the potential revenues generated through tariffs. ■

38 *ISD. 2020. "The Future of WTO Moratorium on Duties on Electronic Transmissions: Why Shouldn't Border Control Be Implemented in the Internet Economy." ISD Indonesia, 23 January. (https://www.isd-indonesia.org/index.php/2020/01/23/the-future-of-wto-moratorium-on-duties-on-electronic-transmissions-why-shouldnt-border-control-be-implemented-in-the-Internet-economy/).*

39 *Asia Pacific MSME Trade Coalition (AMTC) and AlphaBeta. 2018. "Micro-Revolution: The New Stakeholders of Trade in APAC."*

40 *ICC. 2019. "The Business Case for a Permanent Prohibition on Customs Duties on Electronic Transmissions." (https://iccwbo.org/content/uploads/sites/3/2019/11/icc-issues-brief-2-moratorium.pdf).*

41 *Hosuk-Lee Makiyama and Badri Narayanan. 2019. "The Economic Losses from Ending the WTO Moratorium on Electronic Transmissions." ECIPE. (https://ecipe.org/publications/moratorium/).*

42 *ICC. 2019."The Business Case for a Permanent Prohibition on Customs Duties on Electronic Transmissions."*

Given the potential impact of a regionally fragmented and overly burdensome regional e-commerce taxation landscape, spaces for multilateral cooperation and rules-setting provide a unique opportunity to develop direct and indirect tax regimes that do not jeopardise e-commerce growth and participation in the region. However, despite the importance of e-commerce and digital trade in regional growth and the need to streamline and minimise the negative effects of digital taxation policies, to date there have been no regional governance structures that enable the development of balanced and inclusive e-commerce taxation policies across all major countries in the region. This is likely a result of the exclusion of most digital taxation matters from trade agreement negotiations. For instance, the recently signed Regional Comprehensive Economic Partnership (RCEP) does not mention or address any issues related to direct or indirect taxation in its e-commerce chapter.[43] As a result, all parties involved in the trade discussions are left with different approaches to digital trade taxation and are unable to effectively communicate the risks and opportunities associated with various tax collection methods.

At the domestic level, the implementation of e-commerce laws varies across the region and taxation issues are seldom incorporated into their scope. According to UNCTAD's summary of the adoption of e-commerce legislation worldwide, in the Asia Pacific region many countries have not adopted e-commerce-related laws. For instance, only 43% of countries in the region have in place a consumer protection law and 57% have privacy and data protection laws.[44] In such a fragmented regulatory environment, e-commerce laws typically cover areas like online transactions, privacy and cybercrime, but only rarely include taxation issues.

Despite the interest of national governments to pursue e-commerce regulations unilaterally, regional and multilateral initiatives have not been able to develop and enforce common rules that would minimise the compliance and administrative costs of selling goods and services online across the region.

43 *To view RCEP's Electronic Commerce chapter visit https://www.dfat.gov.au/sites/default/files/rcep-chapter-12.pdf*

44 *UNCTAD. 2020. "Summary of Adoption of E-Commerce Legislation Worldwide." United Nations Conference on Trade and Development. (https://unctad.org/en/Pages/DTL/STI_and_ICTs/ICT4D-Legislation/eCom-Global-Legislation.aspx).*

At the multilateral level, initiatives like the WTO's Joint Statement Initiative on E-Commerce (JSI) and the ASEAN E-Commerce Agreement have put in place frameworks that address e-commerce-related concerns like privacy, consumer protection and trade facilitation. However, neither provides a framework for the taxation of e-commerce goods and services.

Under the OECD's inclusive framework of base erosion and profit shifting (BEPS), 137 countries started a process to negotiate the implementation of measures that tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.[45] The initiative includes most of the countries in Asia, with the exception of Cambodia, Lao PDR, Myanmar and the Philippines. BEPS mainly addresses direct and corporate tax concerns by developing rules that ensure the allocation of taxing rights with respect to business profits are no longer "circumscribed" by reference to physical presence and the implementation of a minimum global tax.[46] Despite such progress and a commitment to broker a consensus by the end of 2020, the discussions stalled in mid 2020 after the U.S. withdrew from the talks and Covid-19 pandemic restrictions slowed the pace of talks.[47] While promising, the BEPS initiative remains limited in its ability to develop a common framework for direct forms of taxation and excludes a coordinated approach to indirect forms of tax, which are those that most affect MSME trade costs.

Recent Free Trade Agreements (FTAs) and Digital Trade Agreements provide a potential platform for trade and tax discussions. Agreements like the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP),[48] the Digital Economic Partnership Agreement (DEPA)[49] and Digital Economic Agreements (DEA)[50] prohibit members from

45 *OECD. 2020. "OECD/G20 Inclusive Framework on BEPS: Progress Report July 2019-July 2020." OECD Report. (https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.pdf).*

46 *OECD.2020. "OECD/G20 Inclusive Framework on BEPS: Progress Report July 2019-July 2020." 40.*

47 *Scott, Mark. 2020. "Push for Global Digital Tax Agreement Stalls amid Tensions." POLITICO, 8 January. (https://www.politico.eu/article/digital-tax-taxation-oecd-france-united-states-bruno-le-maire-facebook-amazon-apple-google/).*

48 *CPTPP members that have ratified the agreement include Singapore, Vietnam, Australia, New-Zealand, Japan, Mexico and Canada. CPTPP members that have not ratified the agreement include Brunei, Malaysia, Peru and Chile.*

49 *DEPA members include Singapore, New-Zealand and Chile.*

50 *DEA members include Singapore and Australia.*

imposing customs duties on electronic transactions. However, they do not address issues related to the direct taxation of e-commerce platforms, the harmonisation of indirect taxation regimes and the implementation of *de-minimis* thresholds for both customs duties and consumption taxes.

In summary, existing governance mechanisms have remained limited in their development and enforcement of common digital taxation rules that would minimise key compliance and administrative costs for the online sale of goods and services across the region. ■

DISCUSSION/POLICY RECOMMENDATIONS

With a thriving digital economy, increased economic integration and a dynamic MSME sector, the Asia-Pacific region offers a unique opportunity to develop a dynamic, inclusive and more integrated e-commerce environment. However, the risks posed by a fragmented policy landscape, competing policy priorities, a lack of consideration of the implications of taxation policies on the regional e-commerce ecosystem – especially the operations of MSMEs – and the need to strengthen governance mechanisms promoting a less disruptive and more integrated approach to e-commerce taxation policy, all remain key challenges to e-commerce growth in the region.

To ensure that moving forward, digital taxation policies do not compromise the growth of e-commerce, research and policy initiatives should consider the following principles:

A. Manage the Risks of Direct Taxation Approaches

For businesses, especially MSMEs that rely on online advertisement and e-commerce services to compete in foreign markets, a combination of withholding taxes, permanent establishment, DST or equalisation levy taxes are likely to dramatically increase the costs of those services.

To ensure that direct taxation initiatives do not hinder the ability of businesses to develop internationally competitive products, domestic e-commerce taxation policies and initiatives like the OECD's BEPS, should assess the possible knock-on effects of policies on the broader e-commerce ecosystem – especially their potential to trigger significant price increases for e-commerce services.

B. MSME Friendly and Coordinated Approach to Indirect Taxation

The lack of a common approach to the taxation of e-commerce transactions and the elimination of *de-minimis* thresholds has the potential to be trade prohibitive for MSMEs that rely on low product margins to remain competitive across multiple international markets.

To ensure that indirect tax policies strike a balance between the need to collect taxes and to ensure that these processes are not overly complex nor discriminatory, regulatory approaches should:

- streamline the use of de-minimis thresholds to reduce market entry barriers and compliance costs of MSMEs that rely on low-value-shipment cross-border e-commerce models, and
- promote the development of common approaches and standards for consumption taxes in the region to minimise administrative and compliance costs and the risks of double taxation.

C. Avoid Customs Duties on Digital Products

Most MSMEs employing a cross-border e-commerce model adopt human resources (HR), Enterprise Resource Planning (ERP), financial, logistics, marketing and e-commerce services that best meet their international operation needs. Therefore, a duty on digital products will significantly increase the duty, administrative, production and distribution costs for MSMEs using any type of imported digital product.

Considering the direct costs and the discriminatory nature of imposing tariffs on digital products, regulatory approaches should uphold the WTO moratorium on electronic transactions and work on regional initiatives to use non-discriminatory forms of taxation in a way that does not threaten the dynamism and inclusivity of the regional e-commerce ecosystem. ■

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