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TAX AVOIDANCE IN ONLINE COMMERCE

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ABSTRACT

Legislation is constantly adapting to prevent abusive tax avoidance in all of its forms. Online commerce is an area where abuse is prevalent. As the digital universe is adapting rapidly, there have been and continually are, many incidences of tax avoidance due to insufficient legislation. The paper reviews tax avoidance within three European Union Member States, Germany, Sweden and the United Kingdom. The use of different methods of online commerce, cryptocurrency, online retail and online video game commerce are reviewed. Three main types of online commerce are chosen to show how tax avoidance has taken place in the past and present. The Member States' reactions to new methods of tax avoidance in online commerce are compared.

Member State legislations are compared to show the development of combating tax avoidance within the European Union. The findings show that cryptocurrency is regulated moderately well by the EU Member States, where VAT and income taxes apply when converting cryptocurrencies into traditional currencies depending on the situation. Online Retail is taxed mainly through Value Added Taxes. Video Game Commerce is regulated the least by all three Member States, allowing for tax avoidance. Through these findings, it is apparent that all of the aforementioned online commerce sectors have had and still have potential gaps allowing for tax avoidance. Tax legislation within the Member States is constantly adapting to reduce this.

Keywords: Online Commerce, Tax Legislation, Tax Avoidance

ABBREVIATIONS

CJEU - Court of Justice of the European Union

ECJ - European Court of Justice

EC - European Commission

ECB - European Central Bank

ICT - Information and Communications Technology

VAT - Value Added Tax

INTRODUCTION

Over the last few decades, Online Commerce has grown in leaps and bounds, as shown in the annual survey regarding 'ICT usage and e-commerce in enterprises'[1]. The global online commerce market has almost doubled from 2014 to 2018 according to statistics[2]. This rapid growth has generated interest from corporations as they seek to spread on a global level with relative ease. As a result, this has also drawn attention from States to ensure this evolving method of trade is legislated and taxed[3].

Online Commerce (otherwise known as e-commerce) can be defined as the "buying, selling, exchanging products, services or information via computer networks''[4]. Essentially it is any form of trade of goods or services that is done through information and communication technology. Dr. Jain, in his article Tax Evasion a Dark Side of E-Commerce, explains that a single definition of online commerce is difficult to determine, as the range of activities is growing constantly.

Online Commerce has created great ambiguity in taxation, as new methods of online commerce are being created regularly. Tax legislation must be broad enough to deal with all the new methods without being too broad and creating even more ambiguity[5]. Has tax legislation within the European Union Member States been able to keep up with the advancements in new forms of online commerce? This will be assessed using case precedents as well as comparisons of tax legislations.

The topic of taxation of online commerce was chosen due to the prevalence of online commerce in today's society. The goal is to identify how different methods of online commerce have

[1] (EUROSTAT) E-commerce statistics survey on 'ICT usage and e-commerce in enterprises' [E-database] https://ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce_statistics
[2] (Statista) Retail e-commerce sales worldwide from 2014 to 2021 (in billion U.S. Dollars) [E-database] https://www.statista.com/statistics/379046/worldwide-retail-e-commerce-sales/
[3] Cockfield, A. (2001) Transforming The Internet Into A Taxable Forum - *Ontario Working Papers in Economics, No. 3,* Ontario: University of Toronto Press. 165.
[4] Jain, N. (2013). Tax Evasion a Dark Side of E-Commerce. *International Journal of Engineering and Management Research,* 3(5), 16-18.
[5] Hashimzade, N. (2018). *The Routledge companion to tax avoidance research*. (16th ed.) Abingdon, UK: Routledge.

created a space for tax avoidance and how legislation has adapted to cover them. This will be done through comparing legislation and case studies.

The three European Union Member States that will be discussed are Germany, Sweden and the United Kingdom. Each was chosen as they are part of different legal systems, Germanic, Nordic and Common law respectively. As these are the main legal systems within the European Union, they represent different legislative reactions to different methods of Online Commerce. Have the member states adapted different taxation strategies to cover this rapidly changing area of commerce?

Firstly, online commerce must be evaluated to determine whether there is any legal status of these different methods of online commerce. Three different types of online commerce will be analysed: Cryptocurrencies, Online Retail and Online Video Game Commerce. These three were chosen for different reasons. Cryptocurrencies were chosen due to their unique nature of anonymity and use. Online retail was chosen as it is one of the most common methods of online commerce. Lastly, Online Video Game Commerce was chosen as it has attracted relatively little legal analysis despite the fact that it has a significant and ever growing market size.

After the legal status of the three chosen online commerce methods is determined, the legislation affecting these methods will be analysed in order to gain a clear understanding of how tax legislation has adapted to these new methods of online commerce. This analysis should also determine whether attempts at updating the legislation regarding these online commerce methods have been successful or if there are still gaps that allow tax avoidance.

Subsequently, case studies will be analysed to determine how cases of tax avoidance have been dealt with by the European Union Member States. These case analyses will demonstrate that tax avoidance in the Member States has occurred within online commerce. It will also show how the Member States have chosen to deal with innovations in online commerce taxation. Future proposals will be used where applicable, to show what plans the European Commission has for taxation in online commerce.

Finally, the research analysis will show how the three chosen online commerce methods have created a space for tax avoidance and how Germany, Sweden and the United Kingdom have endeavoured to close those gaps with legislation. The analysis will be combined to put forward a general view on how tax legislation related to online commerce has developed over the years to minimise tax avoidance within the European Union Member States.

1. Chapter 1: Background

Within only four decades, online commerce has gone from non-existent to being used by 1.8 Billion people worldwide[6]. In its early days, online commerce mainly consisted of banking sector transactions. However, when the World Wide Web was released in 1991[7], the online commerce market erupted. Currently online commerce has spread to nearly every retail market sector including even such items as food, clothing and media. With this rapid growth, some of these sectors have often times been either entirely or partially exempt from taxation[8]. Online Commerce is coming out with new methods regularly, allowing for new market segments to enjoy the benefits that online commerce brings. The aim is to find if new methods of online commerce are able to avoid taxation, benefiting consumers and online commerce providers, without having to fulfill any tax obligations[9].

Recently society has moved towards cashless methods of payment, which at first was a benefit for hindering tax avoidance and tax evasion[10]. As Immordino and Russo state, this is due to the increase in data as credit and debit cards create an easy trail for tax authorities[11]. However have new methods of online commerce created a space for tax avoidance?

1.1. Online Commerce

When analysing the legal status of a new form of online commerce, an understanding of the particular type of online commerce should be found. This chapter will focus on three main types

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[6] (Statista) E-commerce worldwide - Statistics & Facts [E-database] https://www.statista.com/topics/871/online-shopping/

[7] Laudon, K. C., Traver C. G. (2008). *E-Commerce: Business, Technology, Society.* (2nd ed.) California, USA: Addison-Wesley.

[8] Chan, C. (2000) "*Taxation Of Global E-Commerce On The Internet*."

[9] McLure Jr, C.E., (1996). Taxation of electronic commerce: Economic objectives, technological constraints, and tax laws. *Tax L. Rev.*, *52*, 269.

[10] García, G.A., Azorín, J.D.B., De la Vega, M.D.M.S. (2018). Tax Evasion in Europe: An Analysis Based on Spatial Dependence. *Social Science Quarterly*, *99*(1), Paris, France: Wiley 7-23.

[11] Immordino, G., Russo, F.F. (2018). Cashless payments and tax evasion. *European Journal of Political Economy*, 55(1), Cambridge, UK: Elsevier. 36-43.

of online commerce which have been chosen as clear examples of tax avoidance exists in each of them. The different forms of online commerce will be analysed to determine whether they have any legal status and therefore any grounds for taxation.

The three chosen online commerce sectors are cryptocurrency, online retail and online video game commerce. These are each unique in lifespan, popularity and legislation, therefore it will show a spectrum of past and present tax legislations that were put in place to combat tax avoidance within the European Union.

1.1.1. Cryptocurrencies Legal Status

Cryptocurrencies such as Bitcoin, Ethereum, LiteCoin and many others have been gaining a lot of attraction in the last few years. Cryptocurrencies can be defined as a 'digital or virtual currency that uses cryptography for security.'[12] Cryptocurrency users can purchase 'Tokens' which allow for secure payments online. As cryptocurrencies use cryptography for security, they have a semi-anonymous nature to them. Thus, unlike money in banks, no central authority, government or individual has access to the users personal information[4].

Cryptocurrency is one of the more difficult online commerce types to define, as it has many uses. Hence it is difficult to determine how it should be taxed. Cryptocurrencies can mainly be seen as a currency or investment depending on the situation.

When determining whether cryptocurrencies are currency, their status as legal tender must be considered. The European Commission has stated that within the euro area, only the euro has the official status of legal tender.[13] However, they also state that although other currencies may not have the status, they can be used if all parties agree together. Therefore, cryptocurrencies should

[12] Frankenfield, J. (2019). Cryptocurrency. Accessible: https://www.investopedia.com/terms/c/cryptocurrency.asp 14 March 2019
[13] European Commission. (2010) *The Euro as a Legal Tender*. Accessible: https://ec.europa.eu/info/business-economy-euro/euro-area/euro/use-euro/euro-legal-tender_en 14 March 2019

be considered as a legitimate currency within the European Union even though they do not have the official status[14].

Cryptocurrencies' main purpose is to act as a form of payment. However, due to the speculative nature and the rapid fluctuation of their values, many consumers of cryptocurrencies have bought the tokens for investment purposes instead of payment purposes. Should it therefore be considered an asset of investment? The European Central Bank has stated that cryptocurrencies (Bitcoin specifically) are a speculative asset[15]. This is important to consider as investments are taxed differently to other methods of income.

1.1.2. Online Retails Legal Status

Online retail in this context will be defined as the sale of goods between two parties using Information and Communications Technology. Prime examples of this include platforms such as Amazon, Ebay and other sites that allow consumers to order products online. Global Online Retail amounted to 2.8 Trillion United States Dollars in 2018[16]. As it its current state, the European Commission has estimated the tax revenue loss to be five billion Euros[17].

The legal status of online retail has become more prevalent in European Union legislation recently. The European Commission has recently made it their aim to put and end to 'online discrimination'[18]. This is form of discrimination is known as Geoblocking, which discriminates based on a consumers nationality or residence[19]. The European Commission is adamant in

[14] Nahorniak, I. (2018) "Cryptocurrency In The Context of Development of Digital Single Market In European Union".
[15] European Central Bank. (2018). *What is Bitcoin?* Accessible: https://www.ecb.europa.eu/explainers/tell-me/html/what-is-bitcoin.en.html 14 March 2019
[16] (Statista) E-commerce worldwide - Statistics & Facts [E-database] https://www.statista.com/topics/871/online-shopping/
[17] European Commission. (2018) *New details on rules for e-commerce presented, including a new role for online marketplaces in the fight against tax fraud*. Accessible: http://europa.eu/rapid/press-release_IP-18-6732_en.htm 16 March 2019
[18] European Commission. (2019) *New EU rules on e-commerce*. Accessible: https://ec.europa.eu/digital-single-market/en/new-eu-rules-e-commerce 16 March 2019
[19] Steppe, R. (2017). Online price discrimination and personal data: A General Data Protection Regulation perspective. *Computer law & security review*, *33*(6), Cambridge, UK: Elsevier. 768-785.

creating equality for European Union consumers to allow equal treatment regardless of their residence.

1.1.3. Online Video Game Commerce Legal Status

Multiple video game companies have implemented micro-transactions into their games. This allows consumers to both buy and sell virtual items. This method of online commerce is mostly consumer-to-consumer, allowing consumers to cash out their virtual items. Although this online commerce form has gone relatively unnoticed, over five billion United States Dollars was spent in 2016 in only one video game alone[20]. The online commerce has created two main online commerce markets, gambling and virtual item investments. The online video game gambling market consists of online gambling sites that allow users to use virtual items as tokens to gamble with. These tokens can then be withdrawn through virtual items of their choosing. The virtual item investment market has emerged due to the speculation surrounding virtual online video game items. Users have invested into certain items, buying in bulk with the speculation that the price will increase, netting them a profit. It is important to distinguish the difference between the two market sectors, as they should be taxed differently.

Similarly to the stock market or any other speculative marketplace, these virtual items prices fluctuate rapidly depending on rarity and speculation. As the prices of these items are purely based on supply and demand of the consumers, this method of online video game commerce should be considered to be an investment asset and therefore taxed as such[21]. Items have appreciated up to 61,000 United States Dollars[22], which shows the potential profits consumers could make without being taxed for any of their speculative gains. However, these investment virtual items can only be cashed out through third party websites, which is where the user should be charged, for example, a capital gains tax.

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[20] Assael, S. (2017). *Counter-Strike has spawned a wild multibillion-dollar world of online casino gambling; it's barely regulated and open to any kid who wants in*. Accessible: http://www.espn.com/espn/feature/story/_/id/18510975/how-counter-strike-turned-teenager-compulsive-gambler 17 March 2019

[21] De Sanctis, F.M. (2019). *Technology-Enhanced Methods of Money Laundering*. (1st ed.) Cham, Switzerland: Springer, 25-41.

[22] Chalk, A. (2018). *CS:GO 'Dragon Lore' AWP skin sells for more than $61,000*. Accessible: https://www.pcgamer.com/csgo-dragon-lore-awp-skin-sells-for-more-than-61000/ 17 March 2019

As for the online video game gambling sector, a majority of the Online Video Game sector have systems that allow a consumer to pay a certain amount and get a random item in return. Should this be considered online gambling? As the items have significantly different price points with a random number generated potential to obtain virtual items up to 61,000 United States Dollars[23], it should be considered online gambling. The UK Gambling Commission stated that any operator that wishes to provide such services using virtual items is obligated to apply for a license from the commission[24].

Although both of these market segments within online video game commerce use virtual items as a substitute for legal tender, they should be taxed differently due to their differences. Investing in these virtual items is similar to investing in more traditional investments like stocks or bonds. They both share the same means and methods, as both methods are speculating that the item's price will increase or decrease. Therefore, the profits from virtual investments should be taxed similarly to investments in traditional assets. However, gambling using these virtual items is different, due to the fact that there is no speculation on the price of the items themselves, as they are just being used as substitutes for legal tender. Therefore, a distinction must be made between the two sectors for tax purposes.

The issue arises on when and where these gambling winnings should be taxed. Valve, one of the leading companies offering virtual items, has attempted to prohibit their consumers from withdrawing their winnings through external sites[25]. As the virtual items only hold value in their online marketplace with no legal tender, it shouldn't be taxable. However, multiple third party operators have created methods to allow consumers to buy and sell their virtual items for legal tender. This raises the question of whether these third party sites should be regulated, as without them there would be no possibility to exchange virtual items for legal tender.

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[23] Chalk, A. (2018). *CS:GO 'Dragon Lore' AWP skin sells for more than $61,000*. Accessible: https://www.pcgamer.com/csgo-dragon-lore-awp-skin-sells-for-more-than-61000/ 17 March 2019

[24] UK Gambling Commission. (2016) *Gambling Commission shines light on virtual currencies, eSports and social gaming*. Accessible: https://www.gamblingcommission.gov.uk/news-action-and-statistics/news/2016/Gambling-Commission-shines-light-on-virtual-currencies-eSports-and-social-gaming.aspx 17 March 2019

[25] Rolando, S., Scavarda, A. (2018). *Gambling Policies in European Welfare States.* (1st ed.) Cham, Switzerland: Palgrave Macmillan.

2. Legislation

This section will analyse the legislation regarding all three chosen methods of online commerce to determine in which ways they can be taxed and if any tax avoidance exists. This will be done through the analysis of court precedents and national laws of Germany, Sweden and the United Kingdom.

2.1. Cryptocurrency Legislation

The inherent problem with cryptocurrencies is that the users remain semi-anonymous. Thus, law enforcement will either have difficulties or be unable to retrieve any user data[26]. When cryptocurrencies are used for payments, users are forced to exchange the cryptocurrency for legal tender unless they use it for the limited amount of available online purchases. Therefore one of the only times that a person using cryptocurrencies could be taxed is when they change cryptocurrencies to Euros, for example. France, among other European Union Member States, has already begun regulating and monitoring the point at which cryptocurrencies and standard currencies are exchanged[27].

This has multiple negative connotations, as the majority of cryptocurrency purchases have been for investment purposes. Some member states have implemented a tax structure regarding cryptocurrencies. However, as there is no European Union directives or regulations, some member states have not specifically provided any cryptocurrency-specific tax laws.

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[26] Marian, O. (2018) "Are Cryptocurrencies 'Super' Tax Havens?" - *University of Florida Faculty Publications.* 46-47

[27] Ministere de Finances et des Comptes Publics, '*Regulating Virtual Currencies: Recommendations to prevent virtual currencies from being used for fraudulent purposes and money laundering*' (VCWG, June 2014)

According to Rosario Girasa, many European Union member states including Belgium, France and Spain have decided to set capital gains taxation on cryptocurrency[28]. Capital gains tax is taxation on profits from assets sold. Therefore, many member states have come to the conclusion that cryptocurrencies are considered an asset in most cases. In Belgium for example, if the investment in cryptocurrencies is deemed to be non-speculative, the sale may be exempt from taxation[29].

Although cryptocurrency can be taxed when transferring to traditional currencies, what if the consumers decide to purchase something directly with their investment cryptocurrency? As cryptocurrencies are semi-anonymous, it would be close to impossible to find the money trail of the consumer purchasing goods or services directly with their cryptocurrency[30]. The sudden gain of expensive goods or services without any money trail could potentially serve as probable cause for a tax investigation related to capital gains.

2.1.1 Cryptocurrency Legislation in Germany

The Hedqvist[31] case has influenced multiple European Union member states, as Germany adopted certain provisions[32] in which the trading of traditional currencies to cryptocurrencies or vice versa would not be subject to VAT. Germany's Ministry of Finance, Bundesminister der Finanzen (BMF), released guidelines related to how cryptocurrencies should be treated by Value Added Taxation[33]. If the use of cryptocurrencies is beyond merely a method of payment, it may

[28] Girasa, R. (2018). *Regulation of cryptocurrencies and blockchain technologies: national and international perspectives*. (16th ed.) Cham, Switzerland: Palgrave Macmillan.
[29] Jupe, E. (2018). Taxation of cryptocurrencies in Europe: an overview. Accessible: https://www.osborneclarke.com/insights/taxation-of-cryptocurrencies-in-europe/ 17 March 2019
[30] Schneider, F., Raczkowski, K., Mróz, B. (2015). Shadow economy and tax evasion in the EU. *Journal of Money Laundering Control*, 18(1), West Yorkshire, UK: Emerald. 34-51.
[31] Skatteverket v David Hedqvist, Case no. C‑264/14
[32] De Broe, L., Goyette, N. and Martin, P., 2011. Tax Treaties and Tax Avoidance. Application of Anti-Avoidance Provisions. *Bulletin for international taxation*, *65*(7), 375-389.
[33] Jenny Gesley, *Germany: Federal Ministry of Finance Publishes Guidance on VAT Treatment of Virtual Currencies*, Global Legal Monitor (Mar. 13, 2018), http://www.loc.gov/law/foreign-news/article/germany-federal-ministry-of-finance-publishes-guidance-on-vat-treatment-of-virtual-currencies/

be subject to VAT on a case by case basis[34]. According to the guidelines set forward by the BMF, changing cryptocurrencies into legal tender is exempt from VAT in Germany.

There are only two taxable methods as provided by the guidelines. The first is paying for goods or services that are provided in Germany shall be subject to VAT. The second is providing a platform for the buying and selling of cryptocurrencies, which can be taxable through VAT. The guidelines provided by the BMF state that other activities, like mining cryptocurrencies and using cryptocurrencies as a payment method are not taxable through VAT.

2.1.2 Cryptocurrency Legislation in Sweden

Sweden has shown initiative in regards to the taxation of cryptocurrencies. So far, the landmark case for cryptocurrency taxation is Case C-264/14 Skatteverket v David Hedqvist[35]. The proceedings between The Swedish Tax Authority and Mr. Hedqvist concerned whether the exchange of Bitcoin and traditional currency or vice versa should be subject to VAT. The ECJ came to the decision that when Bitcoins are used for payment methods, it would be exempt from VAT. The Hedqvist case shows that the European Union is also aware of the online commerce method of cryptocurrencies. Unfortunately, the European Union Parliament has passed no specific legislation in relation to cryptocurrencies or its taxation. To date, the Hedqvist case is the landmark ruling regarding taxation in cryptocurrencies within the European Union.

Similarly to Germany, Sweden does not tax cryptocurrencies heavily using VAT[36], as exchanging cryptocurrencies for legal tender is not VAT taxable according to the guidance released by the Swedish Tax Authority Skatteverket. Profits made through mining cryptocurrencies is also not VAT taxable. In Sweden, according to the guidance of Skatteverket[37], cryptocurrencies are mainly taxed through income tax or corporate tax on businesses that

[34] Commission Regulation (EC) Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC. 16.9.2009

[35] Skatteverket v David Hedqvist, Case no. C‑264/14

[36] Testa, M. (2017)"VAT Treatment Of E-Commerce Intermediaries" - *Journal of Tax Law Commons, No. 4.* Lund: Lund University Press. 10-11.

[37] Finansinspektionen, [Currency Exchanges and Other Financial Activity] (updated Jan. 24, 2017), https://www.fi.se/sv/bank/sok-tillstand/valutavaxlare-och-annan-finansiell-verksamhet/

involve themselves in mining cryptocurrencies or holding cryptocurrencies as stock. The Swedish Supreme Administrative Court's Judgement[38] implies that all cryptocurrencies will have the same tax treatment, from the biggest Bitcoin to smaller altcoins like Litecoin.

2.1.3 Cryptocurrency Legislation in the United Kingdom

The Bank of England took a stand on the taxation of cryptocurrencies. They stated that regulation was needed in the cryptocurrency ecosystem which would combat illegal activities, promote market integrity and protect the financial ecosystem[39]. Her Majesty's Revenue and Customs however stated that cryptocurrencies should not fall under VAT taxation, except for the supplier of goods or services that are purchased using cryptocurrencies in the United Kingdom. The profits made through cryptocurrencies should be taxed on a case to case basis, depending on the kinds of activities the party was involved in[40]. Income tax is the only taxable method except for the aforementioned VAT method in regards to supplying goods or services in the United Kingdom.

2.2. Online Retail Legislation

Online Retail is one of, if not the most used online commerce sectors. The European Union has made it their objective to remove online discrimination from this market sector to ensure equality for all customers and retailers within the European Union. Different methods of taxation have

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[38] Högsta förvaltningsdomstolens dom [Supreme Administrative Court's Judgment] (SAC Judgment), Nr. 7101-13 (Feb. 2, 2016)

[39] Arjun Kharpal, *Bank of England's Carney Calls for More Regulation around the 'Speculative Mania' of Cryptocurrencies*,CNBC (April. 12, 2019), https://www.cnbc.com/2018/03/02/bank-of-england-mark-carney-cryptocurrency-regulation.html

[40] HM Revenue & Customs, *Revenue and Customs Brief 9 (2014): Bitcoin and Other Cryptocurrencies* (April. 12,2019), https://www.gov.uk/government/publications/revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies /revenue-and-customs-brief-9-2014-bitcoin-and-other-cryptocurrencies

been used in this market sector, especially Value Added Taxes and Sales Taxes[41]. However, taxation of this market has occasionally been a controversial topic.

It is not always the corporations that are attempting to evade taxes, as the States have their own incentives for allowing this to take place. There are major social and economical benefits of having major companies headquartered in a State. The issue with this is that European Union Member States have begun competing with each other to make themselves more desirable for these large corporations[42]. Examples of this include Apple in Ireland and Amazon in Luxembourg. In a press release given by the European Commission[43], Luxembourg was found to have illegally given Amazon 'undue tax benefits' worth 250 Million Euros. Luxembourg allowed Amazon to shift their profits from their taxable corporation to Amazon Europe Holdings Technology, which was not subject to taxation[44]. This holdings company had no history in providing any activities that would have warranted the level of royalty payments they were receiving. The European Commission held that Luxembourg was to recover 250 Million Euros from Amazon[45].

Although this was not a successful case of tax avoidance, it shows that even European Union Member States have knowingly allowed corporations to avoid taxes for mutual benefit[46]. Although this is deeply worrying ethically, it shows that European Union legislation is especially advanced in this online commerce sector. However, the concerns of tax avoidance are still prevalent when considering retailers that are not situated in the European Union. Her Majesty's Revenue and Customs stated that 60% of fraud was being practiced by non-European Union online retail sellers[47]. This results in significant tax losses to the European Union countries.

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[41] Reddick, C. (2006) "Electronic Commerce And The State Sales Tax System". *Journal Of Electronic Commerce In Organizations*, vol 4, no. 2, Pennsylvania: Penn Press, 203-212.

[42] Alm, J., Mikhail M. (2012) Cross-Border Shopping And State Use Tax Liabilities: Evidence From Ebay Transactions. *Public Financial Publications,* 3(1), New York, USA: Springer, 51-53.

[43] European Commission. (2017). State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around 250 Million. Accessible: http://europa.eu/rapid/press-release_IP-17-3701_en.htm 17 March 2019

[44] Baugh, B. (2018) Can Taxes Shape An Industry? Evidence From The Implementation Of The "Amazon Tax" - *NBER Publications*, 73-74.

[45] Alm, J., Liu, Y., Zhang, K. (2019). Financial constraints and firm tax evasion. *International Tax and Public Finance*, *26*(1), New York, USA: Springer, 71-102.

[46] Fuest, C. and Riedel, N. (2012). Tax evasion and tax avoidance: The role of international profit shifting. *Draining development*, 109-142.

[47] Gillespie, A.A., Magor, S. (2019). Tackling online fraud. *ERA Forum*, 20(2). Berlin, Germany: Springer, 1-16.

To combat tax avoidance in online commerce, especially from non-EU sellers, the European Union has plans to release a new VAT system for online commerce by 2021[48]. The European Commission stated in the press release that 5 Billion Euros is lost annually in this sector, and that the loss has been on a steady rise. This issue is not an EU specific problem, as the University of Tennessee reported similar findings related to tax losses in the United States[49]. The European Commission's plan is to set up an online portal that would allow corporations to deal with their VAT obligations easily[50]. This proposal is intended to ensure that tax evading corporations and fraudsters cannot undercut VAT compliant corporations. Although it may be impossible to determine what effect this VAT system will have, it shows the European Union's initiative to continuously amend their tax legislation to adapt to new technologies[51].

2.2.1 Online Retail Legislation in Germany

Inside German borders, Online Retail legislation is very strict, with no easily identifiable gaps for aggressive tax avoidance. However, the German Government estimated a loss of roughly 500 million euros annually in unpaid tax revenue from companies outside Germany[52]. In 2014, Germany implemented the European Consumer Rights Directive (Directive 2011/83)[53] into their national law. However, more recently, Germany is planning on releasing a similar VAT system as what the European Union has planned. This VAT plan should come into force two years before the EU's, which should crack down on foreign companies refusing or dodging VAT's. Germany has shown great willingness to crack down on this form of online commerce, as the losses from it are estimated to be extremely excessive.

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[48] European Commission. (2018). VAT: New details on rules for e-commerce presented, including a new role for online marketplaces in the fight against tax fraud. Accessible: http://europa.eu/rapid/press-release_IP-18-6732_en.htm 17 March 2019

[49] William, F. (2001) *State And Local Sales Tax Revenue Losses From E-Commerce - University of Tennessee Center For Business And Economic Research Journals*, 231.

[50] Lang, M., Pistone, P., Schuch, J., Staringer, C., Raponi, D. (2014) Recent Developments in Value Added Tax: The evolution of European VAT jurisprudence and its role in the EU common VAT system. 19th ed. 84-92.

[51] Nasir, L. (2017) Taxation Of Cross Border E-Commerce: Avoidance Of Permanent Establishment And Multilateral Modifications To Tax Treaties. *Journal of International Taxation*, 28(11). Amsterdam, Netherlands: Thomson Reuters. 38-49.

[52] Rohatgi, R. (2005) Principles of International Taxation. 2nd ed. IBFD.

[53] European Consumer Rights Directive (Directive 2011/83)

The VAT plan is expected to have a similar impact as the EU's expected VAT plan[54]. However, it is impossible to determine whether this will have any significant impact beforehand. The anonymous nature of ICT's make it difficult to track all sales of goods and services, making VAT taxation difficult.

2.2.2 Online Retail Legislation in Sweden

Usually the VAT is a taxable amount that the seller endures[55]. However, in Sweden, there is a reverse method. The buyer endures the VAT, which in Sweden is 25%. This takes place when the buyer is in Sweden and the seller is outside of Sweden. Although this method ensures that Sweden receives all VAT taxation, this sets the burden on the buyers.

This method is most likely trying to hinder the fiscal leakage of taxation that online commerce has created. As stated by Beauvallet, it is assumed that fiscal leakage occurs due to tax evasion or due to the existence of a tax liability threshold[56]. The Swedish method of taxation in online retail has been shown to reduce both causes.

This mechanism, in comparison with Germany's current mechanism, will result in less VAT lost by the Government. It also promotes domestic products over imported products due to the lower prices.

2.2.3 Online Retail Legislation in the United Kingdom

Similarly to Sweden, a reverse charge is applied when the provider of a good or service is in a separate member state, assuming the buyer is in the United Kingdom, meaning the buyer will be in obligation to cover the VAT charge. If both parties are in the United Kingdom, the seller will endure the VAT charge[57].

[54] Frunza, M.C. (2018). *Value Added Tax Fraud*. (1st ed.) New York, USA: Taylor & Francis.
[55] Lukas, A. (1999) Tax Bytes: A Primer On The Taxation Of Electronic Commerce - *CATO Institute*.
[56] Bacache Beauvallet, M. (2017). Tax competition, tax coordination, and e‐commerce. *Journal of Public Economic Theory*, 20(1), Paris, France: Wiley, 100-117.
[57] Scarcella, L. (2019). E-commerce and effective VAT/GST enforcement: Can online platforms play a valuable role? *Computer Law & Security Review*, 35(5). Wien, Austria: Springer. 105-371.

As with the Swedish VAT mechanism on online retail, the government will have less tax avoidance due to the buyer covering the VAT if the seller is outside the United Kingdom. This is important as it is far more difficult to track down the seller if they are outside the United Kingdom and force them to cover the VAT.

2.3. Legislation related to Online Video Game Commerce

Similarly to cryptocurrency, online video game commerce is also semi-anonymous. All the virtual items purchased or sold can only be seen by the video game online commerce provider. Therefore, the first issue with taxation on this online commerce, is evaluating the profits a consumer is making through their virtual items that hold both virtual value and traditional value in currency. This should be considered an investment asset, and should be taxed as such using, for example, Capital Gains taxation. This is due to the fact that consumers hold virtual items for multiple years waiting to sell them for a profit[58]. However currently there is no legislation related to the taxation of video game virtual items as investment assets.

The online video game commerce market should be split into two major market segments, gambling and investments[59]. These are the two main market segments in relation to these virtual items. For gambling, users trade their virtual items for tokens on third party gambling sites, and are able to withdraw virtual items back as their winnings[60]. For the investment sector, item prices fluctuate heavily, allowing for speculation and should be therefore considered an investment asset in certain cases. The sales of these virtual items for legal tender can only be done through third party sites, and all sales to these third party sites should be taxed accordingly.

[58] Van Ryn, L., Apperley, T., Clemens, J. (2018). Avatar economies: affective investment from game to platform. *New Review of Hypermedia and Multimedia*, *24*(4), Melbourne, Australia: Taylor & Francis. 291-306.
[59] Ozuem, W., Prasad, J., Lancaster, G. (2018). Exploiting online social gambling for marketing communications. *Journal of Strategic Marketing*, *26*(3), Abingdon, UK: Taylor & Francis. 258-282.
[60] Brooks, G.A., Clark, L. (2019). Associations between loot box use, problematic gaming and gambling, and gambling-related cognitions. *Addictive behaviors*, 96(1), San Diego, United States: Elsevier. 26-34.

If virtual items are bought and never transferred into legal tender, should taxation be applicable? The average user may not fall under the investment criteria, however users that are purchasing large quantities of virtual items, for example, should therefore consider the virtual items as investment assets. If the virtual items are sold on third party sites for legal tender, gambling tokens or other assets, taxation should logically apply. If this criteria is not met, then taxation should not be applicable. If the virtual items are traded for other virtual items but not for the aforementioned assets, it would seem that taxation should not necessarily be applicable.

In its current state, this sector of online virtual item gambling commerce only has individual European Union Member State suggestions regarding taxation. It is important to remember that the Court of Justice of the European Union stated, in the Liga Portuguesa case[61], that member states had jurisdiction to regulate the online gambling market. This means that for this section, the principle of mutual recognition is not applicable.

For the investment market segment of online video game commerce, there is little to no tax regulations currently in place. An option that member states should consider, is setting a capital gains tax on the profits earned when users cash their virtual items for legal tender.

Another issue in terms of taxation in this online commerce segment, is when it is combined with one of the other market segments. For example, a consumer has the ability to buy virtual items using cryptocurrency, making it even more difficult to trace and fulfil the taxation obligations. By default these virtual items hold a 'virtual value' which allows for the trade between users and their items[62]. One of the major stakeholders in this sector of online commerce, Steam, allows users to sell their virtual items for a currency that can only be used in their marketplace. This currency can be used to purchase other virtual items, however it can also be used to purchase other commodities like videogames or electronics. Therefore if a user profited from their virtual item investment, they are able to buy commodities without ever being tax liable.

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[61] Liga Portuguesa de Futebol Profissional and Bwin International Ltd v Departamento de Jogos da Santa Casa da Misericórdia de Lisboa (2009) C-42/07

[62] Vandezande, N. (2017). Virtual currencies under EU anti-money laundering law. *Computer law & security review*, *33*(3), Leuven, Belgium: Elsevier. 341-353.

As currently taxation in this online commerce is up to Member State regulations, the European Commission should consider adopting a European Union wide directive or regulation regarding virtual items and their taxation. This may seem like a very niche sector that does not warrant such legislation, however there are multiple issues that have negative social impacts outside of taxation, like under-age gambling as 10% of the consumers are minors[63]. Although the market sector may be niche, some participants accumulate values of more than 300,000 US Dollars[64]. This shows that significant amounts of money and transactions move in the online commerce market segment.

2.3.1 Online Video Game Commerce Legislation in Germany

There is no German Video Game Commerce Tax Legislation currently. Therefore general provisions would apply. This would not apply for virtual markets that are considered 'closed looped markets', where there is no possibility to convert virtual items for legal tender. Although major gaming companies are pushing their marketplaces to become more and more closed looped, there are currently third-party websites that allow for users to trade their virtual items for legal tender, or purchase virtual items with legal tender. Therefore, in its current state, on a case-to-case basis, capital gains tax or value added tax may be imposed on users converting their virtual items into legal tender. However, in Germany this has not been a focus. Thus, the majority of online video game commerce in Germany is currently untaxed[65]. Germany could consider to adopt a similar approach to the United Kingdom to close the tax avoidance gap.

2.3.2 Online Video Game Commerce Legislation in Sweden

Excluding virtual item gambling, Sweden does not specifically mention online video game commerce or virtual item commerce in its tax legislation. Currently, users are able to buy, sell and trade their virtual items between other users or for legal tender without any concern of any

[63] UK Gambling Commission. (2015) Social Gaming Report. Accessible: https://www.gamblingcommission.gov.uk/PDF/Social-gaming-January-2015.pdf 17 March 2019

[64] Kennedy, L, S. (2019) Tools for Exchange. Retrieved from https://csgo.exchange/home, date used 17 March 2019.

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tax obligations. This has not been a priority for Sweden as of yet, as the online virtual item commerce market is very new[66].

Sweden, as well, could choose to adopt a similar approach as the United Kingdom regarding online video game commerce or online virtual item commerce in order to close the gap allowing opportunities for tax avoidance.

2.3.3 Online Video Game Commerce Legislation in the United Kingdom

The United Kingdom Gambling Commission released a Social Gaming Paper[67] relating to the gambling activities using these virtual items acquirable in the online video game market. The Gambling Commission of the United Kingdom stated that an operator of online virtual item gambling must hold an operating license. The issue is that in the entire Social Gaming Paper released in 2015, there is not one mention of taxation or related issues. This in theory eliminates tax avoidance from online video game commerce, as platforms that currently allow users to exchange virtual items for legal tender could only exist with a license. If all these platforms allowing for trade of virtual items for legal tender were licensed, they could be taxed appropriately. However, currently there are multiple sites that are still active within the UK that allow for the trade of virtual items without a license. Although these sites are acting illegally, due to lack of enforcement, there have been no consequences as of yet.

2.4 Change in Tax Legislation

Are European Union Member States tax legislations adapting to or alongside changes in online commerce? There is evidence that both cases are occuring[68]. Firstly, in the online commerce of cryptocurrency and online video game commerce, EU Member States legislation seems to be dragging behind. This is apparent as the Court of Justice of the European Union has given jurisdiction of the matters to European Union Member States. There is an issue associated with

[66] Agrawal, D.R. (2017) Taxes In An E-Commerce Generation - *CESifo Working Paper Series*, 167-172.
[67] UK Gambling Commission. (2015) Social Gaming Report. Accessible: https://www.gamblingcommission.gov.uk/PDF/Social-gaming-January-2015.pdf 17 March 2019
[68] Yapar, B.K., Bayrakdar, S., Yapar, M. (2015). The role of taxation problems on the development of e-commerce. *Procedia-Social and Behavioral Sciences,* 195(1), Istanbul, Turkey: Elsevier. 642-648.

this, as it creates tax havens within the European Union, which is considered a single-market. The impact of this is that consumers will be drawn to Member States that have more lenient or lower tax rates for these online commerces. It may seem like a niche market in which a consumer would not change residence for tax benefits, however with the emerging market of investing in cryptocurrencies, it may be significant enough for the consumer's livelihood. This essentially creates unequal markets within the European Union, which is not a desirable effect. The European Commission is trying to crack down on Geo Blocking which has the same impact. Same goes for online video game commerce, as consumers will be drawn to Member States that permit online gambling within their State. This creates an unequal market with negative impacts for the European Union as a whole.

European Union Member States tax legislations for cryptocurrency have clearly taken steps towards limiting and removing tax avoidance. However, the European Union needs to consider to implement more specific legislation regarding the issue, as currently legislation is lacking in parts of the European Union[69]. A cryptocurrency regulation could be the solution, however it is impossible to predict the outcomes of what future regulations may impact. Therefore, when looking at past legislation regarding the matter, it is clear that the European Union is aware of the issue and trying to adapt their legislation to the new technologies in cryptocurrency.

Furthermore, tax legislation has had a major visible impact on online retail commerce[70]. The European Union has addressed issues of inequality between Member States as some States have decided to unlawfully allow major retail sellers to avoid taxation. This has major positive effects for the European Union, as countries like Ireland and Luxembourg have been reaping the benefits of having globalized online retailers headquarters in their States with unlawful tax benefits.

The European Union has taken actions against this type of tax avoidance, but it did not stop there however, as it plans to implement a new Value Added Tax system. It should benefit online retailers as they can fulfil their tax obligations with more ease. It should benefit the European

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[69] Sapovadia, V. (2015). *Handbook of Digital Currency.* (1st ed.) Singapore: Elsevier.
[70] Baugh, B., Ben-David, I., Park, H. (2018). Can Taxes Shape an Industry? Evidence from the Implementation of the "Amazon Tax". *The Journal of Finance*, *73*(4), Minnesota, United States: Wiley. 1819-1855.

Union as well as it allows for easier sanctioning of online retail sellers that have not fulfilled their Value Added Tax obligations. This online commerce sector has had major legislation improvements towards reducing tax evasion. It is one of the best examples of online commerce that was legislated quickly and efficiently, to a manner that reduces harmful tax evasion by online retailers. The future of this online commerce appears to be even more secure from tax evasion, however it is impossible to predict the outcome of the proposed Value Added Tax will cause.

Lastly, the online video game commerce has shown signs of worry in terms of online commerce tax legislation. Firstly, consumers that buy or sell virtual items are not taxed by Value Added Tax or any other taxation method. Only gambling is regulated, and even that is based on each European Union Member State's decisions. This online commerce segment has shown some improvements towards reducing tax evasion, however it would appear that it is too niche to be regulated directly by the European Union. This is worrying as some Member States have prohibited this form of online gambling, whilst other Member States have allowed virtual item gambling freely. These virtual items should be considered investment assets, as multiple examples have shown that these items fluctuate in value similarly to a stock exchange. Therefore, they should be taxed as such. This shows that in this specific online commerce, tax legislation has advanced in a few ways, but has still left worrying gaps for tax evasion.

CONCLUSION

The aim of the paper was to analyse how the three chosen member states legislation have dealt with the taxation of new innovative methods of online commerce, and if this legislation still allows for tax avoidance. These three European Union Member States were chosen as they are each from different legal systems, Germanic, Nordic and Common law. Three online commerce sectors were chosen, each for unique reasons. Firstly, Cryptocurrency was chosen as it has generated a lot of interest within the European Union regarding its legality and especially its taxability. It was chosen due to it being a new technology, which allows for analysis regarding how the European Union has reacted to it thus far. Secondly, online retail was chosen for a few reasons. Out of the three online commerces chosen, it has been around the longest, which can be seen from the significant amount of legislation existing related to it. This allows for an analysis of how early legislation dealt with the issue and how it has developed to its current stage. Lastly, online video game commerce was chosen. This is due to it being new and so far relatively unnoticed by the European Union and its Member States. This was chosen as an example of how the member states have dealt with more niche sectors of online commerce.

Firstly, the definitions and uses of each online commerce were given. This was done to ensure that the online commerce was fully defined, allowing for analysis to be more comprehensive later on in the paper. The different uses were analysed to determine whether they had any legal basis for taxation. Examples of each online commerce were also given to give an easier understanding of what the online commerce segments are.

Cryptocurrency was defined as a digital or virtual currency that uses cryptography for security. The main example of cryptocurrency is the Bitcoin, which is the most common cryptocurrency that is referred to due to its value, age on the market and the fact that most other cryptocurrencies are based off the Bitcoin. Cryptocurrency was mainly created as a method for secure online payments, however another use also emerged from the tokens. Many consumers also purchased the tokens for investment purposes. This is important to distinguish as the two methods should be taxed accordingly.

Online Retail, the second online commerce chosen, was defined as the sale of goods between parties using Information and Communications Technology. The main examples used were Amazon and Ebay, as they have both had taxation related issues within the European Union. As online retail consists of the exchange of goods or services, the main tax applicable is the Value Added Tax.

Online Video Game Commerce, the third online commerce chosen, is defined as the buying and selling of virtual items within online video games. This online commerce is mainly business-to-consumer and consumer-to-consumer. However, these virtual items do not fall under Value Added Tax within the European Union at this current moment. This sector of online commerce is also consistent of online gambling, which makes taxation even more controversial. The main example of an online video game commerce provider is Valve, which is important as they have had the most legal traction from European Union Member States.

Subsequently, after determining what uses the online commerces have, the member states legislation was analysed to determine if the online commerces are taxable and to what extent. In certain respects, the online commerce legislation is evolving with the innovations of online commerce, instead of reacting to the innovations.

Cryptocurrency legislation in the European Union is mostly up to Member States. Therefore, some states have decided to tax cryptocurrency withdrawals to traditional currency with Value Added Taxation. Another type of taxation on cryptocurrency is capital gains, as depending on the situation, the consumer's purchase of cryptocurrency could be deemed as an investment asset. This shows that the European Union Member States have rapidly adapted to the online commerce of cryptocurrency. However there are still gaps allowing for tax evasion due to cryptocurrencies' anonymous nature. If the consumer decides to purchase goods or services directly with the tokens, it may be impossible to track and therefore tax. Further research in this specific area should be considered by the Member States and the European Union themselves.

Online retail commerce is more straightforward in comparison to the other two chosen online commerce sectors. This is likely due to the longer lifetime and wider use of the online commerce. However, that does not mean that tax evasion is non-existent in this sector. Roughly 60% of all tax evasion in this sector comes from non-EU online retail sellers, which is why current legislation is being revised to implement a new Value Added Tax system by 2021 according to the European Commission. This new VAT structure shows promise for European Union online commerce taxation, as the EU is constantly adapting their current legislations to ensure tax obligations are met. This not only promotes equality of competition for corporations, but also for Member States. This is due to the current issue of European Union Member States providing unlawful tax benefits to large online retail corporations. An example of this is where Luxembourg was found to have given 250 Million Euros of unlawful tax benefits to Amazon. This takes place as States want large online retailers to set up headquarters in their Member State to have both social and economical positive impacts on their State. The new VAT structure is proposed to eliminate these issues, however it is impossible to predict what impact the proposal will finally have on the Online Retail Taxation.

Video Game Online Commerce has the least legislation out of the three chosen segments. This may be due to it being relatively new and the smaller market sector size. The main concern is the gambling side of commerce. This is governed by each Member State individually. Furthermore, the Court of Justice of the European Union stated that the principle of mutuality should not be applicable to online gambling, therefore allowing every Member State to legislate in their own manner. However, buying and selling virtual items for investment purposes has little to no regulation to date. Currently, Value Added Tax is not applicable to these virtual items either. Therefore the biggest gap for tax evasion potentially is in this segment, most likely due to its low popularity and short lifespan in comparison with the other two online commerce segments discussed.

In conclusion, there is currently room for tax evasion in the new online commerce methods. However, as shown, the Member States have reacted to each online commerce in regards to taxation, showing that they are capable of adapting to the rapid changes in online commerce, even if these market segments are niche.

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