The Testimony of Harris N. Miller
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Good afternoon Mr. Chairman and members of the Committee. On behalf of the 400 members of the Information Technology Association of America (ITAA), many of whom are global information technology companies generating 50 percent or more of their sales revenues in overseas markets, I am delighted to appear before you today.

I am sure I do not need to tell you that America competes in a global marketplace. You may not know, however, that the leading economies around the world spend over $2 trillion on information and communications technology products and services. At over $650 billion, the 15 member states of the European Union represent 85 percent of the total U.S. market for IT products and services. As the EU adds new member states next year, even this small gap in market size will close. A larger European market means a larger, more rational target of opportunity for U.S. firms. While it also means more competition, trade in IT products and services remains one of the few categories in which the U.S. enjoys a global export surplus—an estimated $7.9 billion globally.

The global marketplace brings many good things to the American people, to European, and to individuals around the globe. Lower prices for goods and services. Greater consumer options and choices. More new ideas and innovations. New business growth and employment opportunities. But just as the global market represents new opportunities for growing the U.S. economy, it also poses new challenges for running a truly competitive race.

Best Foot Forward: Competition and the Global Foot Race

In global economics, as in life, not every runner is above sticking out an occasional foot to trip up a foreign competitor. The public policy of nations or groups of nations can become that foot. One might argue, for instance, that the extensive set of European regulatory hurdles that are being erected against genetically modified food fall into this category. U.S. biotech firms are now the unquestioned world leader in this space. Raising market entry barriers gives local competitors the opportunity to catch up.

Other global market "discontinuities" may not be so much a matter of unfair competition but of local norms and conventions; this is particularly when matters are viewed from the often times unconventional perspective of cyberspace. "Disruptive" issues here include privacy rights, Internet governance, consumer protection laws, rules for the international movement of skilled workers, government mandates for use of particular software or hardware, and free speech regulation.

In cyberspace, trade barriers can take a variety of shapes and forms. One of the most significant of these potential barriers is taxation. In this country, we confront periodic

attempts to tax Internet access, even though the basic telecommunications service is already taxed. We see attempts to tax in a discriminatory manner goods and services sold over the Internet in widely geographically divergent locations, even though doing so would create substantial if not devastating collection and administration burdens on the part of small and medium Internet retail businesses. In the US, we hope the House and Senate will soon pass and send to the President a permanent extension of the Internet tax moratorium, including a ban on discriminatory taxes, in the near future, so as not to stifle small and medium enterprises selling over the Internet.

Looking across the sea, several taxes issues are of concern here, including withholding taxes on license royalties and service fees, tax rule complexity, differential taxation rules for financial organizations that do in-house versus outsourced IT work, and the current movement to eliminate the Foreign Sales Corporation/ETI regime.

I have been asked, however, to focus my remarks on the imminent global application of the EU VAT on "Electronically Supplied Services" by US companies to European customers. This move erects a formidable barrier to non-EU businesses and should be the subject of substantial concern to anyone interested in free trade and open markets. Before I start, I would like to recognize the efforts of the Organization for Economic Cooperation and Development (OECD) and, in particular, the Consumption Tax Technical Advisory Group, to bring simplification to the VAT process.

An Even Hand *Should* Be the Hallmark of Any Tax Plan

Equal treatment should be the hallmark of any tax proposal, but this effort is obviously directed at non-EU sellers, and particularly those in our industry. How so? I will be frank: the EU VAT plan discriminates against non-EU sellers, which, at least in the short and medium term will be sellers based in the US. The EU VAT plan requires such sellers to collect and remit the VAT for each EU country in which they have customers—currently 15 countries, soon to be 25--while an EU-based seller need only deal with the VAT rules and rates applicable to the one country in which it operates. The Directive forces non-EU sellers to shoulder the burden of determining customer location, the cyberspace equivalent of shoveling fleas with a fork. Given the wide disparity in VAT rates in the EU—ranging from 12 to 25%--customers have a clear incentive to falsify their countries of residence, and there is no way to know the actual country of residence of any given EU customer unless a physical, as opposed to digital product, is being delivered.

As a result, the compliance bite on non-EU sellers is far sharper than that for their European counterparts. Administrative overhead will be higher for non-EU competitors, and therefore their costs of doing business will be higher. Indeed, for smaller US exporters of software and other digital material, the compliance burden may effectively close off the European market to them.

The problem seems to be getting worse, not better. In early 2002, after several years of considerable trans-Atlantic controversy and debate, the EU adopted the VAT Directive and indicated that it would apply to undefined Electronically Supplied Services (ESS) provided from outside, to within, the EU. In the early going, the ESS definition was thought to be limited in the IT world to digital downloads of content such music and books. During the period between adoption of the Directive and its implementation by EU member states, however, many countries – with guidance from the EU itself –

developed rules that expanded its scope to include marketplace services, for instance, greatly expanding the potential coverage and complexity.

Devil in the Details: Ambiguity Makes a Bad Situation Worse

With a July 1, 2003 start, the new VAT rules are almost upon us. But even so, substantial issues remain to be resolved. Several EU VAT problems stand to trip up non-EU competitors:

- Differing interpretations by member states may generate disparate implementation requirements. EU member states must adopt uniform electronic filing, payment, and record retention standards in order to minimize the cost of compliance for businesses affected by the new rules. VAT **uniformity** must be encouraged but the extent to which this actually happens remains to be seen;

- Non-compliance is a real concern. Where a vendor takes advantage of the simplified registration scheme, a rule or practice should be adopted whereby that vendor will be regarded as satisfying its VAT obligations to all EU member states in connection with electronically supplied services (ESS) if it complies with the implementation requirements adopted by its state of registration, regardless of where its customers reside. Absent such **mutual recognition**, the Directive will fail to achieve the administrative simplification that is intended. This would impose unnecessarily high costs on compliant vendors and, equally troubling, would deter voluntary compliance by many smaller non-EU vendors;

- **Consistency** is critical in a variety of areas, including effective dates, filing dates, deadlines and requirements, tax periods, payment procedures, definitions of ESS subject to tax, treatment of "bundled" goods and services, availability of bad debt relief, use of commercially published exchange rates to convert tax due, and despite the current wording of the Directive which states that tax due should be paid in Euros, a vendor should be allowed to pay the tax in the currency of the sale;

- The VAT may discriminate against the Internet versus other forms of delivery. **Clearer ESS definitional guidelines** need to be issued. These guidelines should be adopted uniformly within the EU. The European Commission, consistent with the 1998 OECD Framework Conditions agreed to in Ottawa, considers the nature of the service--not its mode of transmission—in determining whether it is an ESS. **The Directive should make clear that a service falling outside the ESS definition is not transmuted into an ESS merely because of Internet transmission.** For example, legal advice or advertising copy provided by e-mail should not be treated as an ESS solely because the work product is delivered electronically.

- **Verification** cannot be allowed to delay transactions. Customer status and residence verification requirements must take into account current technical limitations and costs, and the importance of real time online transaction processing. Pending technological developments in this area, companies should be deemed compliant if they use the best information available online in real time during the normal course of a transaction. In the short run, this will prove in

many cases to be customer-provided information. This is particularly true for low-value transactions where the costs of compliance can overwhelm the gain from the transaction for both the vendor and the tax authority. Despite urgings from the US e-commerce community to deal with the inability of US sellers to know with any precision where a EU customer resides (particularly in cases where the item being sold is electronically downloaded by the customer), we are not aware of any EU country that has issued any guidance on this issue;

- Member state tax laws are not synchronized with the VAT implementation start date. The Directive anticipates that **implementing legislation enactment** will take place by July 2003. However, it appears that several EU member states will not have legislation in place by the deadline. Companies should not be expected to collect taxes on behalf of any state until implementing legislation is enacted by such state, and there is sufficient time for companies to become compliant with the legislation;

- If non-established vendors availing themselves of the simplified registration regime will be subject to the rules, interpretation, and compliance regimes of the Member State of identification, then this rule should be embodied within the implementing legislation of each Member State. It would be burdensome and discriminatory if non-EU vendors were to be **subject to audit** by all 15 (soon to be 25) EU Member States, while EU vendors were subject to audit in only one Member State. As noted elsewhere, this would impose unnecessarily high costs on compliant vendors and, equally troubling, would deter voluntary compliance by many smaller non-EU vendors.

- All Member States, other than the Member State of identification, should rely on the results of the audit conducted by the Member State of identification. Such a system of **mutual recognition** would avoid situations where a transaction is considered to be taxable in more than one member state or, alternatively, subject to double non-taxation. Absent mutual recognition, the implementation of a system of arbitration between Member States to resolve promptly any conflicts that arise as a result of differences in the interpretation and implementation of the Directive is needed.

- The proposed Directive is not clear regarding non-EU seller obligations with respect to their **transaction records**. Because non-registered consumers cannot recover VAT on their purchases, the vendor should not be required to issue an invoice. In addition, it is unclear whether these vendors are required to keep records in the language of their customers. For instance, if a vendor sells to a customer located in France, does the vendor need to keep records regarding that transaction in French? It will be burdensome and discriminatory if non-established vendors are required to comply with the record-keeping requirements of all EU Member States, especially when EU vendors are only subject to the record keeping requirements of one Member State. Implementing legislation in each Member State should clarify that it is acceptable to maintain records in English or in the national language of the Member State of identification.

Final Thoughts: Discriminatory Taxes
Dress the Protectionist Wolf in Sheep's Clothing

As I said earlier, an even handed approach should be the hallmark of taxing authorities, whether encountered on Main Street or in the global marketplace. When the EU VAT goes into effect on July 1, non-EU competitors will be asked to run an up-hill course while their EU counterparts enjoy a level track. The situation is, to say the least, unfair.

Collect no VAT or the wrong VAT and, as a non-EU seller, you could be asked to make up the difference or face other legal liabilities. For small companies, that could be catastrophic. Be that as it may: non-EU companies have a statutory responsibility to comply, even though they must play by different rules and, as mentioned, cannot verify the buyer's location. Moreover, the EU and its member countries continue to refuse to provide any reasonable safe harbor mechanism based on customer residency declarations.

The barriers are going up all over Europe and could affect the rest of the world. Today we are talking about 15 countries, but, with the accession of several Eastern European countries, the EU will grow to 25 countries. Furthermore, the EU VAT rule may be copied in other parts of the world where VAT systems are prevalent. This will increase the costs for US information technology companies, narrow profit margins, soak up dollars that might otherwise be reinvested in research, new product development, or productivity enhancement.

European taxes and regulatory barriers that impair access to the marketplace for these industries are protectionism plain and simple. In a matter of days, non-EU based companies who have no physical presence in the EU will be compelled to implement complex and often ambiguous EU VAT rules as a part of their billing systems, as well as having to collect and remit the VAT to the proper EU tax authorities and to become subject to potentially onerous tax audits by EU tax administrators.

All of these conditions will impose significant financial burdens on US vendors, and quite likely cause many US vendors--particularly small to medium sized companies--to forego selling to EU customers in order to avoid the financial risks and costs. In effect, then, these new EU VAT rules are protectionist. They have been designed to help EU vendors by severely limiting the competition from abroad.

What can the U.S. government do about this unfortunate situation? ITAA and its member companies will be monitoring the issue very carefully and, if it turns out to be a discriminatory situation, as we are afraid it might be, we will talk to the US Trade Representative about the possibility of bringing a World Trade Organization complaint. Claiming free trade and open borders while imposing discriminatory VAT is dressing up the protectionist wolf in sheep's clothing.

Short of considering a WTO complaint, we urge US-EU dialog with the goal of giving US companies more time or flexibility to comply with the VAT Directive.

We think it is highly appropriate that this Committee is now examining all aspects of our relations with Europe, including taxes. The VAT and other tax issues are not isolated technical points to be left to specialists. Tax issues are part and parcel of Europe's

overall approach to dealing with the challenge of global business, especially US business, as its markets become more open to international competition.

The Information Technology Association of America is proud to represent so many successful global IT companies. These companies, producing hundreds of thousands of jobs and multimillions of dollars for investors, depend on fair access to European markets. We look forward to working with the Committee to craft solutions to a problem that goes right to the heart of America's global economic leadership. The race is on. America can still be the winner. But only if the tax rules are fair and square.

Thank you very much for this opportunity to testify.

About ITAA

The Information Technology Association of America (ITAA) provides global public policy, business networking, and national leadership to promote the continued rapid growth of the IT industry. ITAA consists of over 400 corporate members throughout the U.S., and a global network of 50 countries' IT associations. The Association plays the leading role in issues of IT industry concern, including trade, information security, taxes and finance policy, digital intellectual property protection, telecommunications competition, workforce and education, immigration, online privacy and consumer protection, government IT procurement, human resources and e-commerce policy. ITAA members range from the smallest IT start-ups to industry leaders in the Internet, software, IT services, ASP, digital content, systems integration, telecommunications, and enterprise solution fields. For more information visit www.itaa.org.