

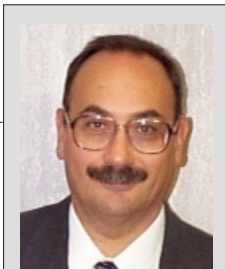
# TechKnowHow

● Industry Intelligence for Eastern Ontario High Technology Professionals

## Putting your business “ON-THE-LINE”

By Hussein Rostum

No matter how much you know about the Internet and e-business, there will always be more to discover and understand. The dizzying pace of growth of e-business is much faster than any one person can ever hope to keep up with. As you read this article, at least 10 new companies have just become e-businesses somewhere in North America. To make understanding e-business a manageable exercise, one must narrow the scope by asking: *What do I need to know about e-business? What business model is right for me? Am I ready for it?*



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**What do I need to know?** E-business uses the Internet to bring companies together with their customers, suppliers and employees in ways never before possible. E-business efficiently connects valuable information to the people who need it. Those who have measured the impact of the Internet on business have produced data that point to sustained, rapid and huge growth trends in e-business. The pundits continue to point to an inevitable conclusion that pretty much the whole business world will be online soon.

But e-business is not just about “going online”; it is about putting your business “on-the-line”. As a company, you need to be prepared to show investors how e-business will make money for them, or how it will save them money. For example, it will *make* them money by increasing sales, expanding markets, diversifying product lines and improving business relationships. It will *save* them money by reducing the cycle time of products, speeding up communications lines, cutting down inventories and generally streamlining business processes. If e-

business is not doing all that for you, then you are not doing it right.

**E-business models.** Nay-sayers believe the inevitable cost of producing and managing a company's web site which by its nature needs to grow and change can severely hamper the return on investment. They do not understand that creating a web site is a beginning, but by itself is not an e-business model. In its mature form, e-business completely transforms many of the fundamental ways that companies run their business. E-business becomes synonymous with business itself.



The electronic business-to-consumer model (B2C) defines companies that aim their business directly to consumers whereas the electronic business-to-business model (B2B) defines companies that aim their business to other companies. The secret to success of B2C and B2B companies is their focus on customer relations management. The Internet generates whole new ways of managing customer relations throughout

Putting your business "ON-THE-LINE" (cont'd)

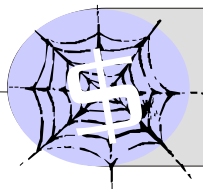
the sales and service cycle, whether this involves consumer products and services or supply chain interactions between companies. Implementing an e-business model in your company entails installing secure order-and-shipping and online payment systems and using the Internet to control your inventories.

As an e-business, your company will also need a smart content management system. Producing and managing your e-business web site content is a big job that

will only get bigger as you grow, embracing virtually all your organization including human resources (training, hiring), marketing, finance, management and planning. The challenge will be to make the costs of your e-presence get smaller and administration of the site easier. You need to consider how a content management system can help you tailor your web site to your evolving needs.

is justified. Companies do not want to be cut out of traditional business markets by up-and-coming global e-competitors. On the other hand, you do not want to deplete your resources while you convert to an e-business model. It may be wiser to iterate into e-business (small steps at a time) which is now an easier and cheaper approach to consider. E-business professional advice and software which allow you to pace yourself can now be bought "off the rack". So just do it!

**Am I ready to put my business on-the-line?** The rush to e-business



## TAXATION in a Web World: Don't get caught?

As the Internet world and the growth in e-business transactions are set to explode, taxation is one of the most important areas in which e-commerce poses challenges for government and business. Governments and business are currently working to address these taxation issues through the Organization for Economic Co-operation and Development (the "OECD"). Part I of this article will address some of the corporate tax issues that are a result of the e-commerce boom while Part II addresses some of the consumption tax issues.



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### Part I

By Charles Murphy



### Corporate Tax Issues

The determination as to where an international transaction should be taxed depends upon the nature of the income and its source. As part of its historical mandate, the OECD has developed a Model Tax Convention which provides guidelines for establishing a particular country's right to taxation, based on the nature and source of various types of income. This determination has become increasingly difficult in a digital world where the line between the provision of goods and services is blurred.

#### Nature of the Income

The taxation of income generally varies depending on whether it is income from business, technical service fees or from royalties. Business income is normally subject to taxation in a particular country where it is earned in connection with a permanent establishment (PE) located in that country. Technical service fees and royalties, on the other hand, are often subject to a non-resident withholding tax imposed under the domestic tax legislation of a particular jurisdiction,

**Part I: Corporate Tax Issues (cont'd)**

which may or may not be reduced under the terms of a tax treaty.

The OECD released its preliminary report in March 2000, entitled *Treaty Characterization Issues Arising From Electronic Commerce*. The report provides recommendations on how the various types of payments in e-commerce transactions should be characterized for purposes of tax treaties. The report looked at 26 types of transactions, including payments for digital information to owners and ISP's.

In broad terms, the report concludes that payments made for transactions involving digitally acquired products are to be treated as business profits and not as royalties. This means that the recipient of such payments may be liable to taxation in the jurisdiction where the business profits arise, subject to domestic taxation rules and treaty exemptions which may apply.

In addition, the report finds that where an ISP or ASP is party to the transaction, it should be viewed as a separate entity carrying on a separate business from the product owner. The ISP or ASP may therefore be subject to tax in the country where the income arises.

This is to be contrasted with the commonly held view that payments for digital information are royalties, subject to non-resident withholding tax.

**Determination of Permanent Establishments**

A country will generally have the first right to tax business income where the business is carried on through a PE in the particular country. Most treaties define a PE to include a fixed place of business or management or a permanent representative with the authority to enter into contracts. Facilities that are solely for advertising, storage or certain other purposes are generally excluded.

The determination of what constitutes a PE can be difficult in a business conducted along traditional lines, with tangible goods, which must be received, stored and shipped. In the digital market place, where goods can be downloaded from servers located almost anywhere in the world, the determination of whether a PE exists becomes even more difficult. To assist in this challenging exercise, the OECD has recently released guidelines on the definition of PE in the context of e-

commerce.

The OECD's draft guidelines make a distinction between fixed automated equipment, such as a server, and the data and software stored on or used by the equipment, such as a website. Under the guidelines:

- a website hosted by an ISP cannot constitute a place of business because it does not involve tangible property at a physical location;
- the server may, however, be a PE for the ISP; and
- If the company that carries on business through the website also owns (or leases) and operates the server on which the website is stored, then that company may be considered to have a PE in the country where the server is located.

In other words, merely hosting a website or owning a server, in and of itself, is probably not enough to create a PE. It will also be necessary to look at other factors, including the enterprise's operation and control of the server and the amount of human involvement.

**Part II**

By Rob Allwright

**Consumption Tax Issues**

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Consumption taxes refer generally to sales taxes, such as the Canadian goods and services tax and value-added taxes, such as the "VAT" imposed in the United Kingdom. Consumption taxes also include provincial and state sales taxes, typically imposed at the retail level.

The OECD is looking at the practical application of the following principles relating to consumption taxes:

Part II: Consumption Tax Issues (cont'd)

**Rules for the application of consumption taxes to cross-border trade should result in taxation in the jurisdiction where consumption takes place.**

An international consensus is being sought on the circumstances under which supplies are to be regarded as consumed in a jurisdiction.

The problem of determining place of consumption may be illustrated by a person who downloads software using a laptop while traveling on business. Is the place of consumption in the jurisdiction where the person is at the time the software is downloaded or the person's usual place of business or residence?

**For the purpose of consumption taxes, the supply of digitized products (e.g., downloading software, music or videos) should not be treated as a supply of goods.**

This means that jurisdictions should not attempt to apply

customs duties to these products or attempt to apply consumption taxes at the border using traditional collection mechanisms.

**Where business and other organizations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of the self assessment or other equivalent mechanisms to collect their consumption taxes.**

This would alleviate the need for foreign suppliers to collect and remit many other countries' consumption taxes.

It is worth noting in this regard that as a result of a proposal accepted by the European Commission, companies not present in the European Union (EU) that provide services online, such as music, videos or software, to consumers in the EU may need to register in an EU member state and start charging VAT to their EU customers by January 1, 2001.

It is our understanding that this proposal does not extend to sales to *businesses*. There will also be a threshold amount of sales, currently proposed at 100,000 Euros. In order to minimize VAT costs to consumers, registration should be in a EU member state with a relatively low rate of tax. We stress that this is a proposal, and a number of legislative and other hurdles must be crossed before the proposal is implemented.

**The growing volume of mail order goods means that procedures and legislation relating to the collection of tax at the border should continue to evolve to ensure the efficient movement of goods, particularly low value, high volume shipments.**

An example of the application of this principle in Canada is the relief from duties and the GST on goods imported by mail and courier shipment and that are valued at not more than \$20.

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