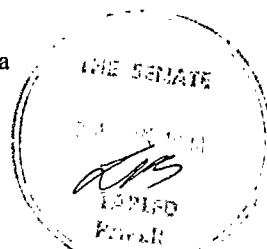


The Parliament of the Commonwealth of Australia

Joint Committee of Public Accounts and Audit



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| DEPARTMENT OF THE SENATE | |
| PAPER No. | 12967 |
| DATE | |
| PRESENTED | |
| 24 JUN 1998 | |
| <i>Mary Evans</i> | |

REPORT 360

Internet Commerce
To buy or not to buy?

May 1998



The Parliament of the
Commonwealth of Australia

Joint Committee of
Public Accounts and Audit

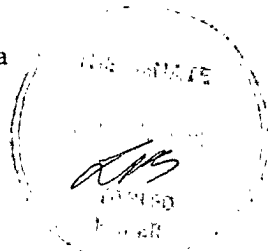
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REPORT 360

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May 1998

CHAIRMAN'S FOREWORD

The Joint Committee of Public Accounts and Audit (JCPAA) is pleased to present this report on internet commerce.

Internet commerce offers new and challenging opportunities to advance international trade. It is essential that there be an effective domestic and international regulatory environment that will encourage the growth of internet commerce.

The inquiry focused on Australian small and medium enterprises, the operation of the Customs screen free limit, the privacy regime, the administration of the taxation system, and the implications for Australia's tax base arising from the growth in internet commerce. The Australian Taxation Office (ATO) advised that there will not be any appreciable impact on tax collections in the next one to two years. Beyond this point it is difficult to make predictions.

In the final years of the 20th century, government and industry are just beginning to comprehend the dimensions and implications of internet commerce. In the next century, we will witness advances in both technology and the way internet commerce is conducted. The question facing us is whether to 'buy' into these new ways of doing business. This report has highlighted some of the challenges for government administration, in particular taxation issues, that will need close attention as internet commerce develops. The JCPAA will continue to monitor this field and return for another examination as it develops further.

The key issues and recommendations in the report include:

- the future of taxation sharing concepts such as source, residency and permanent establishment — the JCPAA is yet to be convinced that the US preference for residency principles is either in Australia's best interests as a taxation formula, or that it is an inevitable development;
- OECD countries should also critically review the applicability of existing taxation concepts, in particular source and residency, and consider how these concepts can be adapted to the internet environment;
- the Australian Treasury and the ATO should report on international developments concerning possible strategies for collecting goods and services tax on products and services ordered and delivered electronically;
- the customs duty and sales tax free limit should remain at \$50;
- the commercial entry thresholds for both postal and non-postal consignments should immediately be set at \$1000; and
- the Australian Government should introduce privacy legislation, with specific reference to information communications, to govern the use of personal information in the private sector.

In conclusion, and on behalf of the JCPAA, I would like to thank all those who have contributed to this inquiry.

Bob Charles MP
Chairman



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MEMBERSHIP OF THE COMMITTEE

Mr Bob Charles, MP (Chairman)¹

Mr Alan P Griffin, MP (Vice-Chairman)

| | |
|------------------------------|------------------------------------|
| Senator H Coonan | Mr L Anthony, MP |
| Senator the Hon R Crowley | Hon D Beddall, MP |
| Senator the Hon B Gibson, AM | Mr R Broadbent, MP |
| Senator J Hogg | Hon J Crosio, MBE, MP |
| Senator A Murray | Mr J Fitzgibbon, MP |
| Senator J Watson | Mr P Georgiou, MP |
| | Hon J Sharp, MP |
| | Mrs S Stone, MP |
| Secretary: | Dr Margot Kerley (from 17.11.97) |
| | Mr Grant Harrison (until 14.11.97) |

¹ Mr A M Somlyay, MP (Chairman) – discharged 22 October 1997.

MEMBERSHIP OF THE SECTIONAL COMMITTEE ON INTERNET COMMERCE

Mr Bob Charles, MP (Chairman)²

Mr Alan Griffin, MP (Vice-Chairman)

| | |
|----------------------------------|------------------------------------|
| Senator Helen Coonan | Mr Larry Anthony, MP |
| Senator the Hon Rosemary Crowley | Hon David Beddall, MP |
| Senator the Hon Brian Gibson, AM | Hon Janice Crosio, MBE, MP |
| Senator John Hogg | Mr Joel Fitzgibbon, MP |
| Senator John Watson | |
| Sectional Committee Secretary: | Mr Stephen Boyd |
| Inquiry Staff: ³ | Ms Georgina Binks Ms Tiana Gray |

² Mr A M Somlyay, MP (Chairman) – discharged 22 October 1997.

³ Other staff who worked on this inquiry include Ms Yolanda Rao, Ms Katherine Fox and Ms Lisa Knight.

DUTIES OF THE COMMITTEE

The Joint Committee of Public Accounts and Audit is a statutory committee of the Australian Parliament, established by the *Public Accounts and Audit Committee Act 1951*.

Section 8(1) of the Act describes the Committee's duties as being to:

- (a) examine the accounts of the receipts and expenditure of the Commonwealth, including the financial statements given to the Auditor-General under subsections 49(1) and 55(2) of the *Financial Management and Accountability Act 1997*;
- (b) examine the financial affairs of authorities of the Commonwealth to which this Act applies and of intergovernmental bodies to which this Act applies;
- (c) examine all reports of the Auditor-General (including reports of the results of performance audits) that are tabled in each House of the Parliament;
- (d) report to both Houses of the Parliament, with any comment it thinks fit, on any items or matters in those accounts, statements and reports, or any circumstances connected with them, that the Committee thinks should be drawn to the attention of the Parliament;
- (e) report to both Houses of the Parliament any alteration that the Committee thinks desirable in:
 - (i) the form of the public accounts or in the method of keeping them; or
 - (ii) the mode of receipt, control, issue or payment of public moneys;
- (f) inquire into any question connected with the public accounts which is referred to the Committee by either House of the Parliament, and to report to that House on that question;
- (g) consider:
 - (i) the operations of the Audit Office;
 - (ii) the resources of the Audit Office, including funding, staff and information technology;
 - (iii) reports of the Independent Auditor on operations of the Audit Office;

- (h) report to both Houses of the Parliament on any matter arising out of the Committee's consideration of the matters listed in paragraph (g), or on any other matter relating to the Auditor-General's functions and powers, that the Committee considers should be drawn to the attention of the Parliament;
- (i) report to both Houses of the Parliament on the performance of the Audit Office at any time;
- (j) consider draft estimates for the Audit Office submitted under section 53 of the *Auditor-General Act 1997*;
- (k) consider the level of fees determined by the Auditor-General under subsection 14(1) of the *Auditor-General Act 1997*;
- (l) make recommendations to both Houses of Parliament, and to the Minister who administers the *Auditor-General Act 1997*, on draft estimates referred to in paragraph (j);
- (m) determine the audit priorities of the Parliament and to advise the Auditor-General of those priorities;
- (n) determine the audit priorities of the Parliament for audits of the Audit Office and to advise the Independent Auditor of those priorities; and
- (o) undertake any other duties given to the Committee by this Act, by any other law or by Joint Standing Orders approved by both Houses of the Parliament.

TERMS OF REFERENCE¹

The Committee shall inquire into and report on the impact of internet commerce on:

- (1) the administration of the Australian taxation system and the implications for Australia's tax base;*
- (2) the international competitiveness of Australian businesses, particularly small and medium enterprises, with the emergence of the internet as a retailing medium; and*
- (3) government industry assistance programs, Customs administration, and the quality and accuracy of Australia's economic and trade statistics.*

In conducting its inquiry the Committee will consider:

- (a) the expected growth in internet commerce;*
- (b) the findings of and solutions proposed by the Task Force on Electronic Commerce established by the Commissioner of Taxation;*
- (c) the quantity, value and type of goods entering Australia under the duty and sales tax free limit, and the commercial entry thresholds, administered by the Australian Customs Service;*
- (d) the appropriateness of the existing duty and sales tax free limit, and the commercial entry thresholds, referred to in paragraph (c), and the implications, costs and benefits of any alteration to these limits and thresholds;*
- (e) the commercial opportunities (both domestic and export opportunities) afforded to Australian firms by the growth in internet commerce;*
- (f) the current frameworks for consumer protection and the protection of intellectual property;*
- (g) the opportunities for Commonwealth agencies to improve services to the business sector and to the general public arising from growth in internet commerce;*
- (h) the extent to which the Government's potential responses to the growth in internet commerce are affected by international agreements or conventions; and*
- (i) the policy approaches being taken by other countries and the scope for international cooperation.*

¹ The Committee initiated the inquiry under the powers set out in the *Public Accounts and Audit Committee Act 1951*.

LIST OF ABBREVIATIONS

| | |
|-----------|---|
| AA | Arthur Andersen |
| ABA | Australian Bankers Association |
| ABS | Australian Bureau of Statistics |
| ACA | Australian Consumers Association |
| ACCC | Australian Competition and Consumer Commission |
| ACN | Australian Company Number |
| AFTA | Australian Fishing Tackle Association |
| AGs | Attorney-General's Department |
| AMRA | Australian Music Retailers Association |
| ANAO | Australian National Audit Office |
| ANZAAB | Australian and New Zealand Association of Antiquarian Booksellers |
| AP | Australia Post |
| APCC | Australian Privacy Charter Council |
| ARA | Australian Retailers Association |
| ASCPA | Australian Society of Certified Practising Accountants |
| ASTEC | Australian Science, Technology and Engineering Council |
| ATO | Australian Taxation Office |
| CAPEC | Conference of Asian Pacific Express Couriers |
| CBCA | Customs Brokers Council of Australia |
| CLEB | Commonwealth Law Enforcement Board |
| Committee | Joint Committee of Public Accounts and Audit |
| CSIRO | Commonwealth Scientific and Industrial Research Organisation |
| DFAT | Department of Foreign Affairs and Trade |
| DIST | Department of Industry, Science and Tourism |
| DoCA | Department of Communications and the Arts |
| DPIE | Department of Primary Industries and Energy |
| DTA | Double Taxation Agreement |
| EC | European Commission |
| EU | European Union |
| FBCA | Federal Bureau of Consumer Affairs |
| FID | Financial Institutions Duty |
| GST | Goods and services tax |
| G7 | Group of 7 (Canada, France, Germany, Italy, Japan, UK, and US.) |

| | |
|-------|---|
| GII | Global Information Infrastructure |
| HTML | Hyper Text Mark-up Language |
| HTTP | Hyper Text Transfer Protocol |
| IAP | Internet Access Provider |
| IBSA | International Banks and Securities Association of Australia |
| IC | Industry Commission |
| ICD | Informal Clearance Document |
| IIA | Internet Industry Association |
| IP | Internet Protocol |
| IPAC | Information Policy Advisory Council |
| ISP | Internet Service Provider |
| JAA | Jewellers Association of Australia |
| JCPAA | Joint Committee of Public Accounts and Audit |
| Kbps | Kilo-bits per second |
| Mbps | Mega-bits per second |
| NAB | National Australia Bank |
| NACCA | National Advisory Council on Consumer Affairs |
| NOIE | National Office of the Information Economy |
| OECD | Organisation for Economic Co-operation and Development |
| OGIT | Office of Government Information Technology |
| OSP | Other Service Provider |
| RAPS | Risk Assessment Profile System |
| RSE | Relative Standard Error |
| SMEs | Small and Medium Enterprises |
| TACP | Tax Advantaged Computer Program |
| TCF | Textile Clothing and Footwear |
| TCP | Transmission Control Protocol |
| URL | Uniform Resource Locator |
| VAT | Value Added Tax |
| VSAT | Very Small Aperture Terminal |
| WIPO | World Intellectual Property Organisation |
| WST | Wholesale Sales Tax |
| WTO | World Trade Organisation |
| www | world wide web |

RECOMMENDATIONS

CHAPTER TWO INTERNET COMMERCE STATISTICS

Recommendation 1

The Australian Bureau of Statistics should:

- (a) conduct on an annual basis the Household Use Of Information Technology Survey; and*
- (b) wherever possible include internet commerce and usage data items into all existing business and economic surveys. (paragraph 2.43)*

CHAPTER FOUR AUSTRALIAN TAXATION ADMINISTRATION

Recommendation 2

The Australian Taxation Office must continue to monitor the risks to income tax and the tax system generally from internet commerce, continue to enhance methodologies for determining revenue loss, and report its findings on a regular basis in its annual report. (paragraph 4.23)

Recommendation 3

Treasury and the Australian Taxation Office should report on international developments concerning possible strategies for collecting GST on products and services that are ordered and delivered electronically. (paragraph 4.24)

Recommendation 4

The Parliament should refer future Bills relating to internet commerce to the Joint Committee of Public Accounts and Audit for an advisory report to the Parliament. (paragraph 4.40)

Recommendation 5

Any legislative amendments arising from recommendations of the Australian Taxation Office be referred to the Joint Committee of Public Accounts and Audit for an advisory report. (paragraph 4.78)

Recommendation 6

That State Governments, in consultation with the Australian Government, abolish Financial Institutions Duty and Debits Tax. (paragraph 4.86)

CHAPTER FIVE

THE CUSTOMS SCREEN FREE LIMIT

Recommendation 7

The Auditor-General should examine, as part of any performance audit he undertakes into parcel and letter screening, compliance with Australian Customs importation guidelines and possible ways compliance can be improved. (paragraph 5.42)

Recommendation 8

Australian Customs and Australia Post should examine improvements that can be made to, and international progress with, bar coding and related item identification systems for imported goods and advise the Joint Committee of Public Accounts and Audit. (paragraph 5.43)

Recommendation 9

The duty and sales tax free limit should remain at \$50. (paragraph 5.137)

Recommendation 10

The commercial entry thresholds for both postal and non-postal consignments should immediately be set at \$1000. (paragraph 5.138)

Recommendation 11

The Auditor-General should review the level of revenue leakage from customs screening, and suggest ways in which screening methodology could be improved. (paragraph 5.139)

Recommendation 12

Australian Customs should proceed with stage three of the survey into low value imported goods and ensure that:

- (a) the right to conduct the survey is determined according to Australian Public Service tender procedures; and*
- (b) a representative of the retailing industry is on the coordinating committee for the survey. (paragraph 5.140)*

Recommendation 13

When the results are available from stage three of the survey into low value imported goods, the Australian Government should, using that data and other relevant information, consider whether to change the \$50 duty and sales tax free limit to a \$150 goods value limit. (paragraph 5.141)

Recommendation 14

Australian Customs must:

- (a) establish an ongoing data series which records statistical information on the quantity, value and type of goods entering Australia under the screen free limit; and*
- (b) publish this data in the Australian Customs Service annual report. (paragraph 5.142)*

CHAPTER SIX GROWTH OPPORTUNITIES FOR AUSTRALIAN SMEs

Recommendation 15

The Industry Commission should conduct a multi-industry inquiry focusing on, but not limited to, structural changes in the economy, development and growth issues for industry, and regulatory requirements arising from the growth in internet commerce. (paragraph 6.77)

Recommendation 16

The Auditor-General should conduct a multi-agency performance audit, during 1999, of the efficiency and effectiveness of government service provision through the internet, taking account of, but not limited to:

- (a) the effectiveness of measures to provide security and privacy; and*
- (b) strategies for ensuring access and equity. (paragraph 6.78)*

CHAPTER SEVEN CONSUMER PROTECTION AND PRIVACY ISSUES

Recommendation 17

That the Australian Government introduce privacy legislation, with specific reference to information communications, to govern the use of personal information in the private sector. (paragraph 7.75)

1

INTRODUCTION

Background

1.1 On 25 June 1997 the Joint Committee of Public Accounts (JCPA) resolved that it would conduct a broad ranging inquiry to examine the implications of the expected growth in internet commerce.

1.2 On 1 January 1998, following amendment to the *Public Accounts Committee Act 1951*¹, the JCPA became the Joint Committee of Public Accounts and Audit (the Committee) and subsequently resolved to resume the review.

1.3 Three factors led to the Committee initiating this inquiry. First, were the rapid advances that were occurring with internet communications, reports of dramatic increases in internet usage rates, and expectations that internet commerce will continue to grow exponentially. With these trends in mind it was also evident that significant challenges would be created for tax administrations in maintaining taxation revenue. The efficiency and effectiveness of tax administration is a key concern of the Committee.

1.4 Second, the Committee received representations from a number of industry associations about the revenue, business, employment and trade implications of the increase in the volume of commercial transactions now occurring via the internet.

1.5 A further factor that arose during 1997 was the international response by various countries and communities to the global growth in internet commerce. Prominent amongst these was the policy response by the United States Government. In July 1997, President Clinton released the report *A Framework for Global Electronic Commerce*.

1 The title of the Act was changed to *Public Accounts and Audit Act 1951*.

President Clinton recommended that the internet should be declared a tariff-free environment and no new taxes should be imposed on internet commerce.

1.6 In April 1997, the Commission of the European Communities released the statement, *A European Initiative in Electronic Commerce*. This report suggested that certain features of the internet created new possibilities for tax avoidance and evasion. The report concluded that these concerns should be addressed in order to safeguard the revenue interests of governments and prevent market distortions.

1.7 In view of the domestic and international developments occurring in relation to internet commerce, the Committee determined that it was timely for it to conduct a broad ranging inquiry into this matter.

Objectives of the inquiry

1.8 Internet commerce offers new and challenging opportunities to advance international trade. While the Committee has set itself clear objectives, the overarching theme for the inquiry is to promote and encourage the new opportunities for commerce and international trade created by internet communications. The internet will transcend national boundaries and countries that seek to shield themselves from its effects will be disadvantaged in the long run. Australia must seek to be at the forefront of this communications revolution and compete aggressively in this new market place.

Taxation issues

1.9 The terms of reference for the inquiry focus on three key areas. The first, as discussed above, is the impact of internet commerce on tax administration and Australia's tax base. Internet commerce offers new purchase and payment systems that can be made highly secure through encryption systems. The system is global in size and potentially offers consumers with a wider choice of goods and services than ever before.

1.10 The same opportunities to access international services applies to banking and financial services. There are frequent reports that the internet will provide greater opportunity to engage in offshore banking in tax havens. These features of internet commerce pose significant challenges for tax administration. A key objective for the Committee, therefore, is to assess the impact of internet commerce on tax administration. In August 1997, while the Committee was conducting its inquiry, the Australian Taxation Office released the report *Tax and the Internet*. This report provided the Committee with a sound base from which to examine the impact of internet commerce on taxation administration.

1.11 The Committee addresses taxation issues in the knowledge that internet commerce is an evolving market which has yet to reach maturity. Therefore, the Committee has set out to increase its knowledge of these matters and assist the Parliament to better understand the challenges that internet commerce poses. It is inadvisable for the Committee to make specific and far reaching recommendations, regarding taxation matters, that could tie Australia to unilateral action and which may, in the long term, prove to be inappropriate. Taxation issues are discussed in Chapters 3 and 4.

The competitiveness of Australian SMEs

1.12 The second issue is an examination of the international competitiveness of Australia's small and medium enterprises (SMEs) in an internet environment. The internet has created the potential for a global market. Consumers will have far wider sources to choose from when purchasing goods and services. This will create a new level of competition which has no precedent. Australian SME's will have the opportunity to extend their reach and compete in new and distant markets. At the same time, Australian SMEs will be subject to increasing levels of competition from SMEs and large corporations in other countries. It is, therefore, important to examine how Australian SMEs are responding to challenges created by internet commerce. These matters are discussed in Chapter 6.

The customs screen free limit

1.13 An immediate issue raised by internet commerce is Australian Customs administration of the 'screen free limit' for low value imported goods. Some retailing organisations, in evidence to the inquiry, claimed that the internet will lead to an increase in imported goods which are not subject to duty and sales tax. Some Australian retailing groups claimed that this created a distinct price advantage and incentive for Australian consumers to purchase goods and services from overseas suppliers. Further, it was claimed that if this situation went unchecked then the future of some retailing industries would be in doubt. The Committee's objective, therefore, was to test these claims against statistical evidence of growth, if any, in low value imported goods.

1.14 The Committee's investigation of low value imported goods led to the first detailed study of the quantity, value and types of goods entering Australia under the screen free limit. Australian Customs officials advised the Committee that this data would not have been collected were it not for the Committee's inquiry.

1.15 The appropriateness of the customs screen free limit is discussed in Chapter 5.

Security and privacy

1.16 The final part of the inquiry focuses on the role of the consumer in internet commerce. Some of the key considerations for the consumer include security and privacy of transactions, and consumer protection. The internet is an open system so conducting commercial transactions must be done with secure systems and methods in place. The market is responding to this need with the introduction of secure payment systems such as Secure Electronic Transactions (SET).

1.17 Consumers value privacy and may be reluctant to participate in internet commerce if adequate security and privacy is not provided. Yet the internet enables the storage and retrieval of a wide range of information about individual spending patterns. Australia and other countries are seeking to address these issues by ensuring that privacy will be protected. Australia is currently developing a self-regulatory privacy regime for the private sector. In contrast, the

European Union (EU) prefers a legislated approach and is seeking reciprocity from other countries. A key objective for the Committee is to assess the effectiveness of Australia's self regulatory privacy approach and contrast it with the EU's strategy. Consumer protection and privacy issues are discussed in Chapter 7.

1.18 The previous objectives reflect the major items in the terms of reference. There is, however, a broader objective of the inquiry. The dramatic changes that internet commerce has the potential to create are not completely understood and are yet to be fully realised. It is essential, therefore, that industry and government plan now and establish systems to ensure that Australia is a leader in this new form of commerce.

1.19 It is essential that Australia advance effective and persuasive international taxation agreements and other legal frameworks at international fora. In view of these issues, an overarching objective of the inquiry, therefore, is to help promote broad recognition of the opportunities and challenges created by internet commerce.

Conduct of the inquiry

1.20 On 8 and 9 August 1997, the Committee advertised, in *The Australian Financial Review* and *The Weekend Australian*, terms of reference for an inquiry into internet commerce and invited submissions from interested individuals and organisations. In addition, the Committee wrote to a range of industry organisations, government agencies, banks, universities, internet associations and professional journals seeking submissions. As with all inquiries, in recent times, the terms of reference and other information about the inquiry were advertised on the Committee's internet homepage at:

www.aph.gov.au/house/committe/jpaa/index.htm

1.21 Over 80 submissions were received and are listed at Appendix 1. The submissions came from individuals, industry organisations, banks and government agencies. The Committee also received 37 exhibits which are listed at Appendix 2. For the first time in the history of the Joint Committee of Public Accounts and Audit, submissions were received via email. The Committee's email address is:

jcpa@aph.gov.au

1.22 During the inquiry, the Committee received private briefings from the Australian Taxation Office (ATO), the National Office for the Information Economy (NOIE) and the Commonwealth Scientific and Industrial Research Organisation (CSIRO).

1.23 Evidence was taken at public hearings held in Canberra, Melbourne and Sydney during October, November and December 1997. A round table forum was conducted in Canberra in February 1998. This brought together the major groups that had appeared at earlier public hearings, and provided for constructive discussion on the issues under consideration by the Committee. There was additional value in the round table forum because it provided communication between agencies and organisations which do not usually discuss issues directly with each other. A list of witnesses appearing at the hearings can be found at Appendix 3.

1.24 Copies of the transcripts of evidence from the public hearings and the volume of submissions are available from the Committee secretariat and for inspection at the National Library of Australia. The transcripts of evidence are also available on the Hansard website at:

www.aph.gov.au/hansard/joint/commnttee/comjoint.htm

1.25 In conjunction with the public hearings, the Committee also inspected the International Mail Exchange at Clyde, New South Wales and Australian Customs Administration at Tullamarine Airport, Melbourne, Victoria.

1.26 In view of the number of disparities in available statistics on internet usage and commerce, the Committee commissioned internet research company www.consult.com.au to assist with the provision and analysis of internet commerce statistics.

1.27 The Committee appreciates the assistance of the Economic, Commerce and Industrial Relations Research Group, Parliamentary Library, for providing advice during the writing of the report.

Report structure

1.28 The report structure reflects the key objectives of the inquiry. Chapter 2 sets the scene for the report by discussing the quality and accuracy of available internet statistics.

1.29 Chapter 3 examines the relationship between internet commerce and taxation administration. Chapter 4 focuses on Australian Taxation Administration and its response to internet commerce.

1.30 The fifth Chapter explores Australian Customs administration and the operation of the 'screen free limit'.

1.31 Chapter 6 examines SMEs' opportunities and challenges arising from internet commerce.

1.32 The final chapter examines internet commerce from the perspective of the consumer. Some of the key points here include security, privacy and consumer protection.

International focus

1.33 The internet is synonymous with 'international'. No study of the internet can be undertaken without considering what is occurring internationally. At the same time, consideration of internet commerce requires a change in the way business, government and communities think about and assess these types of issues. The internet as an information, communication and commercial system is being heralded as a new international economic development. Some groups suggest that its significance and implications rates with previous economic developments such as steam power or railway.

1.34 In view of the unprecedented nature of the internet, this inquiry has attempted to ask new questions about commerce and communications. Where possible, all aspects of the inquiry are compared and contrasted to developments internationally.

1.35 In contrast to our major trading partners, this inquiry is one of the first of its type conducted by a national parliamentary committee. A senior representative of the Australian Taxation Office advised the Committee of this fact

during the round table forum in February 1998 in Canberra. The Committee is aware that the United States (US) Congress is currently debating the Internet Tax Freedom Act which was the subject of various US committee inquiries. In comparison, however, the Committee's inquiry covers more than just taxation issues. The Chairman of the Committee, Mr Bob Charles, MP, stated:

...Mr Killaly did say that, to the best of his knowledge, this inquiry is the most comprehensive inquiry being undertaken by any parliament in the OECD. Recognising that, it puts a significant amount of pressure on this Committee. On behalf of the Committee, I am certain that we want to respond appropriately. We will deliberate very carefully and I will recommend to the Committee that I write to corresponding bodies in all the parliaments of the OECD and send them a copy of our report.²

1.36 The Committee's purpose in sending copies of this report to other legislatures is to emphasise the international context of this issue and to promote dialogue between elected representatives of OECD countries.

Relevant reports and inquiries

1.37 Information technology issues have been the subject of a number of recent reports. The Committee has attempted to keep abreast of developments in this area. The Australian Government has released a range of reports examining the impact of internet commerce. For example, in 1997 the Corporate Law Economic Reform Program released the report, *Electronic Commerce, Cutting Cybertape – building business*.

2 Mr Bob Charles, Chairman, Joint Committee of Public Accounts and Audit, *Transcript*, 3 February 1998, p. 554.

In March 1998, the Electronic Commerce Expert Group to the Attorney-General released the report, *Electronic Commerce: Building the Legal Framework*.³ Three notable Australian reports the Committee has considered, but not limited its examination to, include:

- the review of business programs undertaken by Mr David Mortimer, *Going for Growth: Business Programs for Investment, Innovation and Export*, June 1997;
- the report of the Information Industries Task Force, chaired by Mr Ashley Goldsworthy AO, *The Global Information Economy—The Way Ahead*, July 1997; and
- the report of the Information Policy Advisory Council, *A national policy framework for structural adjustment within the new Commonwealth of Information*, August 1997.

1.38 The Government's recent policy statement, *Investing for Growth*⁴, was assisted by the findings and recommendations in the previous reports. This report stated:

The internet is rapidly extending the scope for electronic commerce. Doing business electronically enables companies to be more efficient and flexible, to work more closely with their suppliers, and to be more responsive to the needs and expectations of their customers. The major benefits will accrue to those companies willing to change their business processes to fully exploit the opportunities offered.⁵

3 Corporate Law Economic Reform Program, *Electronic Commerce, Cutting Cybertape – building business, Proposals for Reform: Paper No. 5*, AGPS, Canberra, 1998;
Report of the Electronic Commerce Expert Group to the Attorney-General, *Electronic Commerce: Building the Legal Framework*, March 1998.

4 *Investing for Growth, The Howard Government's Plan for Australian Industry*, December 1997.

5 *Investing for Growth, The Howard Government's Plan for Australian Industry*, p. 66.

1.39 Some of the key initiatives in *Investing for Growth* include:

- facilitating electronic commerce through commitments to removing tariffs on information industries inputs, ensuring goods ordered and delivered electronically will remain customs duty free and that there will be no 'bits' tax on the internet;
- developing a range of programs aimed at encouraging business and community take-up, improving access for people with disabilities and those in remote areas; and
- establishing the Government as a leading-edge user through the adoption of new technologies for access to government information and service.⁶

The internet

Background

1.40 The internet was established in 1969, by the US Department of Defense, for the purpose of creating a communications system that could survive a world war. The design of the internet, incorporating numerous networks, provides various routes to get a message from A to B, thus making it attractive for defence purposes if a particular communication line was down. When a user sends a number of messages to the same destination, there is no pre-determined route as the messages may take various paths to arrive at the same destination.

1.41 The internet can be considered a 'network of networks' comprising private, corporate, public and academic computer networks. These different networks are linked through the use of common information protocols such as the Internet Protocol (IP) and Transmission Control Protocol (TCP). The terms 'information superhighway' or 'Global

6 *Investing for Growth, The Howard Government's Plan for Australian Industry*, pp. 65-66.

Information Infrastructure' (GII) are used to refer to the 'convergence of previously separate communications and computing systems into an interoperable, global network of networks'.⁷

1.42 As communications technologies become more advanced, the capabilities of the system will increase. For example, transmission capacity will increase as transmission systems change over to fibre optic cable. In addition to fibre optic cable there is the use of digitisation to convert text, sound and images into a common digital format. Through these developments, the internet will be able to transmit a wide spectrum of information such as videos, x-rays, and a range of services into the household incorporating voice telephony and cable television.

The world wide web

1.43 The world wide web (www) is a user interface system used for accessing the internet. The communications protocol is called Hyper Text Transfer Protocol (HTTP). The web is a multimedia system blending text, images, video and audio instead of just straight text. The web also links documents to documents which provides a convenient user system. To access the web, users need a net browser such as that produced by Netscape or Microsoft Explorer. The user interface is simple to use and based on a system of pointing and clicking the mouse.

1.44 The web was developed from a 1989 university research project to develop a better method to share research results with other scientists. A further feature of the web is the creation of websites. Users access websites by entering a web address called a Uniform Resource Locator (URL). In some cases, a user will not know the URL and will need to use a 'Search Engine' such as Yahoo, Lycos, Infoseek or Altavista to locate the appropriate URL. An organisation or individual can create a home page or website in which it stores, for the use of others, information about itself. For example, the Committee's web address or URL is:

www.aph.gov.au/house/committe/jpaa/index.htm

7 US Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, November 1996, p. 5, [www.ustreas.gov].

1.45 It is through the creation of websites that retailers advertise and make possible the purchase of goods and services. At January 1998, it was estimated that there were 54 800 enterprise websites in Australia.⁸

1.46 Domain names are the names following the @ in an email address, or following the http:// in a web address. The domain name system (DNS) 'translates internet names into the IP [internet protocol] numbers needed for transmission of information across the network'.⁹ Therefore, it is the DNS that allows computers to be referred to by a name rather than a number.¹⁰

1.47 The management of the DNS partly resides with the US Government. On 1 July 1997, President Clinton, as part of *A Framework for Global Electronic Commerce*, directed the Secretary of Commerce to privatise, increase competition in, and promote international participation in the domain name system.

1.48 On 20 February 1998, the US released a draft plan, in the form of a Green Paper, on the Technical Management of Internet Names and Addresses. The Green Paper stated:

*Technical management of the internet should reflect the diversity of its users and their needs. Mechanisms should be established to ensure international input in decision making. In keeping with these principles, we divide the name and number functions into two groups, those that can be moved to a competitive system and those that should be coordinated. We then suggest the creation of a representative, not-for-profit corporation to manage the coordinated functions according to widely accepted objective criteria.*¹¹

1.49 The European Commission (EC), however, has noted some concerns with the US proposal for the management of internet names and addresses. The EC

8 www.consult.

9 US Department of Commerce, *A Proposal to Improve Technical Management of Internet Names and Addresses*, 20 February 1998, [<http://www.ntia.doc.gov/ntiahome/domainname/022098fedreg.txt>].

10 McRea, P. and Smart, B., CSIRO, *The Internet Report*, Prepared for the Australian Taxation Office, *Tax and the Internet*, Volume 2, p. 101.

11 US Department of Commerce, *A Proposal to Improve Technical Management of Internet Names and Addresses*.

commented that the 'US proposals could, in the name of the globalisation and privatisation of the internet, consolidate permanent US Jurisdiction over the internet as a whole'.¹²

1.50 On 6 May 1998, the Australian Government responded to the US Green Paper on domain names.¹³ The Australian response supported the US Government's proposal to disengage from governance of the domain name system but noted the following five major concerns with the US strategy:

- **Risk of unduly dominant role for US jurisdiction and interests:** 'The proposal in the Green Paper would place the not-for-profit governing body under US jurisdiction. As a result the body would be subject to the US law and US courts, and, without appropriate measures to ensure adequate right to non-US interests, could unduly benefit US-based stake holders'.
- **Representation and accountability concerns:** 'There is not adequate consideration in the Green Paper of how the governing body should be accountable to national governments'.
- **Anti-competitive effects:** 'The database of names in the registry system should be owned by the governing body, in trust for the public, and the registry system should be managed by the governing body'.
- **Concerns over trademark and dispute resolution:** 'The Green Paper does not adequately promote international dispute resolution procedures, which could remove much of the cost and inequity of resolving disputes within particular national jurisdictions'.

12 European Commission, *European Commission proposes a Draft Reply of the EU and its Member States to the US Green Paper on Internet Governance*, 25 February 1998, [www.ispo.cec.be/eif/dns/ip98184.html]

13 Response of the Commonwealth Government of Australia to the proposed rule of the US Department of Commerce: *A Proposal to Improve Technical Management of Internet Names and Addresses*, 6 May 1998, [www.noie.gov.au/dns/ausreply.html].

- **Concerns over transition strategy:** 'The Green Paper proposes specific US Government action in a number of detailed operational areas. These decisions and actions should be the responsibility of the governing body'.¹⁴

Technical developments

1.51 The internet is undergoing continuous technical development which will influence internet usage and commerce. Some of the key developments include improvements in speed, download times, simpler user systems, more effective searching and browsing systems and, through these factors, access to a range of new and sophisticated services. Paul Budde states:

*The network has the potential to grow into the much discussed information superhighway. Daily new technological breakthroughs on the internet are reported, telephony, radio and interactive video are all available on the Net. Most of these new developments are in their very early stages, but it is a clear indication of things to come. By using cable TV and satellite TV platforms for the delivery of the service the broadband problems will be pushed back further.*¹⁵

1.52 The Sacher Report suggests that three features of a market environment will be influenced by technical developments in internet commerce. They include:

- *the access dimension* – electronic communication infrastructures are required to allow buyers and sellers to make and maintain contact with each other, and to facilitate the transfer of information about products and customer needs into the market-place;

14 Response of the Commonwealth Government of Australia to the proposed rule of the US Department of Commerce: A Proposal to Improve Technical Management of Internet Names and Addresses.

15 Paul Budde Communication, *Internet and Online Service Markets in Australia and New Zealand, 1997*, Volume 1, Australia, p. 16.

- *transaction dimension* – specialised technologies are required to support kinds of structured information exchanges that are related directly to the setting up and completion of commercial transactions, and the performance of contractual obligations; and
- *support dimension* – other specialised technologies are required to lend administrative and technical support to transactions carried out in the electronic market-place.¹⁶

1.53 Key technical developments are those that improve access and lead to mass market penetration. Web TV, for example, will provide an interface system that is claimed to be easier and more accessible to consumers than existing interfaces.¹⁷ It is expected that web TV will be available in Australia during 1998.¹⁸ The ATO commented:

*The interface metrics of a TV style device, turn it on and change channels, are significantly less complex than existing computers, and many consumers have no inclination to learn such interfaces in order to shop...*¹⁹

1.54 A new generation internet, referred to as Internet 2, with speeds in excess of 100 to 1000 times the speed of the existing system is expected early in the next century. This will help to improve the efficiency and effectiveness of ordering and delivering goods over the internet. In February 1998, President Clinton indicated that the US Budget would include 'US\$110 million to develop the next generation internet in partnerships with leading US high-tech companies and universities'.²⁰

16 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, OECD, Paris, 1997, p. 34, [www.oecd.org/dsti/sti/it/ec/act/sacher.htm].

17 Paul Budde Communication, *Internet and Online Service Markets in Australia and New Zealand, 1997*, p. 8.

18 *The Australian Financial Review*, 5 January 1998, p. 27.

19 Australian Taxation Office, *Tax and the Internet*, Volume 1, AGPS, Canberra, 1997, p. 41. The report can be downloaded from [www.ato.gov.au/ecp/].

20 Clinton Administration, *Remarks by the President to Technology 98 Conference*, 26 February 1998. Search via 'Whitehouse Documents' [www.whitehouse.gov/WH/html/library.html].

Bandwidth

1.55 Bandwidth indicates the carrying capacity of a network. That is, the amount of data that a network connection can carry at one time. A simple rule is the greater the bandwidth, the greater the opportunity for delivering data rich goods and services such as movie videos and music CDs. Australia's international bandwidth capacity has increased significantly in recent years as shown below:

| | | |
|---|-----------|---------------------------------|
| • | May 1994 | 1.5 Mbps (mega bits per second) |
| • | May 1995 | 1.5 Mbps |
| • | May 1996 | 6 Mbps |
| • | June 1996 | 30 Mbps ²¹ |

1.56 Telstra, as an internet access provider (IAP), provides the main internet link with the US. At January 1998, Telstra had 156Mbps of cable capacity to the US, 45Mbps of asymmetrical satellite capacity, and a further 4 to 6Mbps of cable capacity. In addition, there is another 140Mbps of capacity which is non-Telstra. This consists of OzEmail – 45Mbps, OGN – 45Mbps, UUNet and UUNet/Optus for AVCC – 42Mbps, AT&T – 8Mbps, and Sprint Global One – 8Mbps.²²

1.57 The Department of Communications and the Arts (DoCA), in evidence to the inquiry, indicated that while Telstra has 'increased the capacity of its international links to meet increasing traffic demand, congestion on the US link is still, from time to time, a constraining factor on the performance of the Australian network'.²³

1.58 The Australian Science, Technology and Engineering Council (ASTEC) raised a similar concern warning that 'there is likely to be a bandwidth shortfall between Australia and North America, the major internet link

21 Paul Budde Communication, *Internet and Online Service Markets in Australia and New Zealand, 1997*, p. 16.

22 www.consult.

23 Department of Communications and the Arts, *Submission*, p. S587.

from Australia to the world, within the next 12 to 18 months'.²⁴ ASTEC warned that this limitation could affect the commercial objectives of Australian SMEs.

1.59 Possible limitations in bandwidth have been the focus of some journal articles. *Internet Infrastructure*, for example, suggested that Australia's international cable capacity faces limitations if present internet growth rates continue. At the same time, it was suggested that planned submarine cable systems such as Jasura, Sea-Me-We 3, South Cross and Project Oxygen 'should serve to dramatically increase the available bandwidth over the next few years'.²⁵

1.60 To explore the issue of a possible bandwidth shortfall, Telstra, Optus and British Telecom were brought together at a round table forum before the Committee. Telstra gave reassurances that its network, with the addition of satellite services, would be able to cope with increased demand for internet services. Telstra stated:

*Six months ago there was a belief that there would be a bandwidth shortfall. However, with the planning that has taken place with the cable networks that we have and, more importantly, the stuff that we are starting to see with satellite coming on stream, our very firm belief is that there will not be a bandwidth shortfall in the next 12 to 18 months. Satellite is probably one of the most exciting technologies we have seen for Internet, in particular, for an alternative to backbone cable to the US. The other issue is that we are diversifying our links significantly into Asia, which is also taking some pressure off the networks going direct to the US.*²⁶

1.61 Optus agreed that there will not be a shortfall in bandwidth. Optus indicated that it is exploring the use of satellite technology, and seeking to send internet traffic directly to the Asia Pacific Rim rather than via the US.²⁷ British Telecom raised questions about digital data access and

24 Australian Science, Technology and Engineering Council, *Submission*, p. S348.

25 Lynch, G., 'Australia's Internet Infrastructure: still breathing, not yet bursting', in *Internet Infrastructure*, October 1997, pp. 99-100.

26 Mr John Rolland, Telstra, *Transcript*, 15 December 1997, p. 376.

27 Mr Omar Khalifa, Optus, *Transcript*, 15 December 1997, p. 377.

pricing issues. These are being addressed by the Australian Competition and Consumer Commission.²⁸

1.62 The direction and flow of internet traffic between Australia and the US was also raised in discussions. The Industry Commission (IC) indicated that when international capacity was first established, internet traffic was mostly from the US to Australia. Australian access providers pay the full cost of this international capacity.²⁹

1.63 Today, however, about 70% of internet traffic flows from the US to Australia with the remaining 30% in the opposite direction. However, Australian access providers continue to pay the full cost of international capacity between Australia and the US.³⁰ The IC suggests that US internet access providers should be paying for the 30% of internet content sourced from Australia.

1.64 According to the IC, this 30% represents a subsidy of approximately US\$15 million per year to US internet access providers. The IC claims this will, ultimately, be met by Australian internet users and could grow as more internet content is sourced from Australia.

1.65 Telstra has submitted a petition to the US Court of Appeals to review a Report and Order on international settlement rates issued by the US Federal Communications Commission. The IC suggested that the cost of international capacity should be shared between Australia and the US on the basis of traffic flow. The IC proposed that the Committee should note this mounting cost impost on Telstra and 'consider the potential role for government in advancing discussions between Australian and US carriers on this issue'.³¹

Conclusions

1.66 Bandwidth capacity is one of the key technical factors which could have implications for the international competitiveness of Australian SMEs. If there is a shortfall in bandwidth between Australia and international markets,

28 Ms Elizabeth Williams, British Telecom, *Transcript*, 15 December 1997, p. 379.

29 Industry Commission, *Submission*, p. S373.

30 Industry Commission, *Submission*, p. S373.

31 Industry Commission, *Submission*, p. S374.

particularly the US, then Australian SMEs may be disadvantaged. Both DoCA, and ASTEC warned of a possible shortfall in bandwidth capacity between Australia and the US.

1.67 The Committee investigated these matters by questioning Telstra, Optus and British Telecom about the claims made by ASTEC. Telstra acknowledged that during mid 1997, a bandwidth shortfall was being suggested. Telstra, however, advised the Committee that there 'will not be a bandwidth shortfall in the next 12 to 18 months'. Optus and British Telecom did not reject this view. Some of the reasons for this include, developments with cable networks, more satellites coming on stream, and the fact that Telstra and Optus indicated that they are diversifying their links into Asia which is taking pressure off the networks going to the US.

1.68 The Committee rates bandwidth capacity as a threshold issue for the successful development of the internet. Its importance cannot be underrated. At the same time, the Committee accepts the strong assurances from Telstra that there will not be a bandwidth shortfall in the next 12 to 18 months. Therefore, the Committee encourages Telstra and other internet access providers to continue to provide Australia with world best standard infrastructure. The Committee will not make any recommendations on this matter but will continue to monitor Telstra's provision of bandwidth.

1.69 Key issue

A further issue that warrants the attention of the Committee is the direction of internet traffic between Australia and the US. The Industry Commission (IC) indicated that where once internet content was all from the US to Australia there is now about 30% Australian internet content going to the US. Telstra continues to pay for all internet traffic which represents a subsidy to US internet access providers of approximately US\$15 million per year. This figure is expected to increase as Australian internet content increases. The IC proposed that the Committee consider the potential role for government in advancing discussions between Australian and US carriers on this issue.

The Committee believes this action would be premature. Telstra is one of the world's largest

telecommunications companies and is already engaged in international negotiations on this matter. Telstra has submitted a petition to the US Court of Appeals seeking to address the issue of settlement rates issued by the Federal Communications Commission.

Rural and remote access

1.70 The internet offers a range of benefits to rural and remote communities. These benefits include social, recreational and economic opportunities. SMEs in rural and remote areas can benefit from more advanced ordering systems and wider markets.

1.71 The Department of Foreign Affairs and Trade has detailed a number of case studies in which regional and rural SMEs are selling products around the world.³² For example, Mick's Whips, a company based in the Northern Territory, uses the internet as its sole marketing tool for selling its goods around the world. The Australian Retailers Association commented on some of the benefits of the internet for rural and remote retailers:

*There are opportunities for retailers in rural areas to be more competitive, to access supplies at better rates and display products to local consumers better than they currently can. By the same token, there are opportunities for city retailers to sell directly into country areas. Country consumers are likely to be beneficiaries of this kind of trade, and it will greatly increase the range of goods that they can get.*³³

1.72 Some of the benefits for SMEs include getting timely access to market information, cheaper and more accurately targeted advertising and promotion, more effective ordering and purchasing of stock, and improved performance in the sale and just-in-time distribution of agricultural products and livestock to consumers overseas. Some of the benefits that the internet offers remote residents include:

32 Department of Foreign Affairs and Trade (DFAT), *Putting Australia on the New Silk Road, The Role of Trade Policy in Advancing Electronic Commerce*, National Capital Printing, Canberra, 1997, p. 9.

33 Mr David Shetliffe, *Transcript*, 5 November 1997, pp. 126–127.

- better access to social services such as health advice and counselling;
- more options for entertainment and leisure activities;
- better access to education and training;
- running a business, or holding a second job, from home; and
- social networking.³⁴

1.73 Some of these issues have been examined in other parliamentary inquiries. In October 1997, the House of Representatives Standing Committee on Family and Community Services released a report on Telemedicine.³⁵ This report discussed telecommunications services to rural and remote areas including internet access.

1.74 The House of Representatives Standing Committee on Financial Institutions and Public Administration is currently conducting an inquiry into alternative means of providing banking and like services in regional and remote Australia. It is expected that this inquiry will explore telecommunications capabilities, including internet access, to rural and remote communities.

1.75 DoCA, in its submission to the inquiry, discussed the adequacy of the telecommunications infrastructure to rural and remote areas. DoCA advised that 'the existing infrastructure in many rural and remote areas is currently no more than that necessary to carry voice traffic'.³⁶ The House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform revealed similar concerns through its inquiry into rural and remote letter delivery services.³⁷

34 Department of Primary Industry and Energy, *Submission*, p. S252.

35 House of Representatives Standing Committee on Family and Community Affairs, *Health on Line, A Report on Health Information Management and Telemedicine*, AGPS, Canberra, 1997.

36 Department of Communications and the Arts, *Submission*, p. S588.

37 House of Representatives Standing Committee on Communications, Transport and Microeconomic Reform, *Keeping Rural Australia*

1.76 DoCA claimed, however, that future improvements in service provision could be expected. For example, Telstra's fibre optic backbone extends into Australia's regional centres and large towns. In addition, it is claimed that telecommunications deregulation from 1 July 1997 will create fairer access to networks for new carriers and service providers. For example, AAPT SatTel is now offering a Very Small Aperture Terminal (VSAT) product that is specifically tailored for the needs of rural and remote communities. VSAT is expensive for individual users but is cost effective for remote communities that are able to share bandwidth, and link to individual users through terrestrially based systems.³⁸

Conclusions

1.77 In conducting this inquiry, the Committee has a responsibility to consider access to the internet by rural and remote communities. The internet provides advantages for SMEs and consumers living in these areas. But the Committee notes that in some rural and remote areas there are inadequacies with communications infrastructure. For example, the Department of Communications and the Arts advised the Committee that in some rural and remote areas communications infrastructure could only support voice traffic.

1.78 It has, however, not been possible to conduct a detailed review of the telecommunications infrastructure existing in rural and remote areas. It is possible that this issue will be addressed by the House of Representatives Standing Committee on Financial Institutions and Public Administration which is examining telecommunications infrastructure in rural and remote areas as part of its inquiry into alternative means of providing banking and like services in regional and remote areas. The Committee will monitor developments in this area and examine the findings and recommendations of the Financial Institutions and Public Administration Committee.

Posted, An inquiry into Australia Post: Rural and remote letter delivery services, AGPS, 1996, p. 44.

38 Department of Communications and the Arts, *Submission*, p. S590.

2

INTERNET COMMERCE STATISTICS

Introduction

2.1 The size and nature of internet commerce is not fully understood. There is a range of conflicting information about internet usage and the types and patterns of domestic and international internet commerce. It is essential that the range of statistics describing various features of internet commerce be comprehensive and reliable so as to ensure that business decisions, and policy responses by government are appropriate. The Committee considers this examination a major part of this inquiry.

2.2 A review of internet commerce statistics is the starting point for assessing the various components of internet commerce. This Chapter will examine various statistical databases relating to internet usage and levels of commerce in Australia and in other OECD countries. A key objective of the report is to ensure, where possible, that international developments are monitored.

2.3 It should be noted that many of the statistics in this report are likely to have changed and be out of date fairly quickly due to the rapid rate of change in the various internet markets.

2.4 Internet usage including current levels, future levels, growth rates, and types of usages are key indicators of current and future levels of commerce. This section will define an internet user, discuss user demographics and examine how many people are using the internet now and what is expected in the future. The reasons why people are using the internet are discussed as well as technical developments in internet delivery systems that may encourage greater participation.

2.5 Internet commerce can be defined in various ways. Some definitions include all forms of electronic commerce such as transactions through telephone, fax and electronic data interchange from business to business. This section will

discuss the appropriateness of these definitions and suggest a suitable definition for the purpose of this inquiry. Next, some features of internet commerce will be discussed including reasons for internet shopping, major products bought and sold, and the value of goods and services commonly bought over the internet.

Internet usage

2.6 There are different sources of internet statistics which reveal wide variety in internet usage numbers, future numbers and growth rates. For example, various sources suggested that internet users in Australia between 1996 and 1997 ranged from 300 000 to 3.5 million. Estimates for the United States (US) ranged from 29 million to 56 million during 1997.¹ The Department of Communications and the Arts (DoCA) commented:

Statistical surveys of Internet use are notoriously unreliable and accurate forecasts are difficult to obtain. Surveys may vary considerably in the sensitivity or sophistication of sampling techniques used. Most are based on extrapolation of small population samples to the wider population. Yet Internet use may vary widely between populations in different socio-economic groups or geographical locations.²

2.7 It is clear then that business and government users will need to be discerning in their selection and use of available statistics. The following sections examine various components of internet usage and discuss the available statistics. The discussion is divided into the following parts:

- consumer demographics;
- factors affecting consumer uptake;
- comparison of new and experienced users and their main concerns;
- patterns of business usage;

1 Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, p. 511.

2 Department of Communications and the Arts, *Submission*, p. S512.

- levels and growth rates of internet usage in Australia and OECD countries; and
- government statistics.

Consumer demographics

2.8 The standard demographic information about internet users includes age, sex, education and income. There are a number of sources³ that provide information on these demographics, but figures generally conform to those shown in Table 2.1.

Table 2.1: Demographic information about internet users

| Demographic | Paul Budde Communications | www.consult |
|--------------------|---------------------------|-----------------------|
| Dominant age group | 24 to 40 years (average) | 20 to 49 years |
| Gender | 82 % male | 80 % male |
| Education | 70% further education | 70% further education |
| Income | 50% over \$50 000 | 50% over \$50 000 |

Sources: Department of Communications and the Arts, *Submission*, p. S529. Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998.

2.9 Table 2.1 portrays an average user as male, tertiary educated, high income earning and aged between 20 to 49 years. Some of these features are changing over time. The proportion of school age children using the internet has increased slowly from June 1996 to December 1997. In the same period the user rates for females has increased from 12% to 20%. Similarly, users with high school education, as the highest level, has increased from 20 to about 30%.⁴

3 See Department of Communications and the Arts, *Submission*, pp. S528–533.

4 Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, pp. 511–512.

2.10 Internet users may be using the internet for different purposes, and demonstrating different patterns of usage and access. An examination of these features helps to define an internet user. For example, some users may be casual, regular, have a private account, a shared account, use public access, access from home, access from work, and have private and business uses.⁵ Some of the reasons for internet use are shown in Table 2.2.

Table 2.2: Internet uses by primary and secondary activity

| Use | Primary activity | Secondary activity | Total |
|---------------------------------|------------------|--------------------|--------|
| email | ≈ 23% | ≈ 67% | ≈ 90% |
| software downloads | ≈ 5% | ≈ 65% | ≈ 70% |
| entertainment | ≈ 14% | ≈ 51% | ≈ 65% |
| news and reference | ≈ 6% | ≈ 54% | ≈ 60% |
| business and research | ≈ 20% | ≈ 35% | ≈ 55% |
| academic/research | ≈ 11% | ≈ 41% | ≈ 52% |
| education | ≈ 4% | ≈ 46% | ≈ 50% |
| experimenting | ≈ 2% | ≈ 33% | ≈ 35% |
| chat | ≈ 4% | ≈ 30% | ≈ 34 % |
| hobbies-other | ≈ 2% | ≈ 30% | ≈ 32% |
| hobbies-sports | ≈ 1% | ≈ 22% | ≈ 23% |
| shopping/financial transactions | ≈ 0% | ≈ 21% | ≈ 21% |
| discussion groups | ≈ 0.5% | ≈ 19.5% | ≈ 20% |
| else | ≈ 1% | ≈ 4% | ≈ 5% |

Source: www.consult.

2.11 The figures in Table 2.2 show the low emphasis that internet users place on commercial activities. Shopping or financial transactions did not even rate as a primary activity.

5 www.consult.

In terms of the overall time spent online by internet users, shopping and financial transactions are clearly derivative or secondary activities.

Factors affecting consumer uptake

2.12 There are a number of impediments for consumers which are restricting internet uptake and commerce. The chief impediment is the cost of on-line services. Next are concerns relating to privacy, security and consumer protection. These issues are discussed in more detail in Chapter 7.

2.13 These key concerns were underpinned by research conducted by www.consult. It indicated that internet security concerns are affecting around 15 to 20% of users in December 1997.

Comparison of new and experienced users and their main concerns

2.14 New internet users (less than 6 months experience online) and 'experienced users' (more than 2 years online experience) have different concerns with internet usage.

2.15 For users with less than 6 months online experience, the top concerns at December 1997 were:

- cost of internet access 21%
- security of financial transactions 20%
- privacy of individuals 16%
- response times 16%
- I have no concerns 8%
- obtaining value for money 5%
- inappropriate/indecent material 5%
- cost of upgrading PC and modem 4%
- something else 3%
- junk email 2%

2.16 For users with more than 2 years experience online, the top concerns at December 1997 were:

- response times 25%
- cost of internet access 22%
- security of financial transactions 13%
- privacy of individuals 10%

- I have no concerns 10%
- junk email 9%
- inappropriate/indecent material 3%
- obtaining value for money 3%
- cost of upgrading PC and modem 3%
- something else 3%⁶

Patterns of business usage

2.17 Information is available about internet awareness, uptake and usage patterns by small business. The Yellow Pages Small Business Index, *Survey of E-Commerce in Australian Small and Medium Businesses, April 1998*, revealed a range of statistics about small business. The Index claims to be the largest economic survey of small business in Australia with small business defined as having up to 19 employees. Previous surveys were conducted in February 1994, May 1995, May 1996 and May 1997.

2.18 One of the initial findings in the Yellow Pages survey focused on internet computer ownership and usage. Ownership of computers and modems is widespread. Across all small and medium businesses, 76% used computers of one sort or another, and some 42% of small businesses owned modems. More than half (54%) used computers as much as possible and were on the lookout for more ways of using computer technology.⁷

2.19 As of April 1998, 45% of those small businesses using computers, or more than one-third of all small businesses, were connected to the internet. In May 1997, the contrasting figures showed that 30% of small business using computers, or 23% of all small businesses, were connected to the internet.

2.20 The April 1998 survey also found that of those businesses with computers who were not connected in May 1997, 11% had connected in the 9 months since May 1997. This was slightly less than the expected growth.⁸

6 www.consult, *New Wave Internet User Report*, April 1998.

7 Yellow Pages Small Business Index, *Survey of E-Commerce in Australian Small and Medium Businesses*, April 1998, pp. 2-4.

8 Yellow Pages Small Business Index, *Survey of E-Commerce in Australian Small and Medium Businesses*, p. 6.

2.21 Some of the perceived main uses or benefits of the internet for the small businesses in the Yellow Pages survey included:

- research/looking for information 36%
- access/exchange information 28%
- e-mail 28%
- advertise/promote products 26%
- another form of communication 17%
- international market contact 13%
- look at products/services 10%
- locate new clients/tenders 7%
- buying/selling/bookings 6%
- fun/browsing 6%

2.22 For those businesses connected to the internet, the main uses were:

- e-mail 88%
- reference or research data 83%
- look for product information 77%
- advertise products 59%
- provide information to customers 59%
- access directories 56%
- network with other businesses 55%
- place orders for products 48%
- provide facility for customers to buy 44%
- monitor markets 41%
- update exchange rates, weather etc. 34%
- pay for products 24%

2.23 For those businesses that did not intend to connect to the internet, the main reasons given for this, included:

- no need/no benefit 58%
- haven't got round to it 16%
- don't know enough about it 12%
- too expensive 10%
- planning connection in future 9%
- need to update system 5%
- looking into it 5%
- worried about viruses 4%⁹

9 Yellow Pages Small Business Index, *Survey of E-Commerce in Australian Small and Medium Businesses*, pp. 7-9.

2.24 These figures go some way to providing information about SMEs' market knowledge and awareness of the potential of the internet. The results, however, require further analysis. For example, it is not possible to adequately appraise the reason why 58% of businesses have 'no need/no benefit' without knowing the types of businesses involved.

Levels and growth rates of internet usage – Australia and OECD countries

2.25 Estimates of the number of internet users in Australia and other countries varies depending on the data source. For example, between 1996 and 1997 estimates of internet users in Australia ranged from 300 000 to 3.5 million.

2.26 Growth forecasts for internet usage also vary. For Australia, growth forecasts range from four to five million by the year 2000. For the US, growth forecasts range from 27 to 94 million. Table 2.3 sets out estimates of internet usage levels in Australia and other OECD countries. For most countries, a range of estimates, by research company, are shown.

2.27 From the information in Table 2.3, the www.consult figure of 1.6 million users in Australia can be broken down into the following groups:

- consumer and small office/home office 540 000
- business and government leased lines 11 000
- business and government users 450 000
- academic users 450 000 to 600 000 ¹⁰

2.28 The figures in Table 2.3 demonstrate the range of estimates and, therefore, shows the need for caution in using figures for policy making and business decisions. Private sector internet research companies are competing to provide their clients with the most up to date and reliable figures. Australia also has the benefit of a highly credible government statistical agency, the Australian Bureau of Statistics (ABS).

¹⁰ Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, p. 512.

2.29 The ABS, in its *Household Use Of Information Technology 1996 Survey*, showed that 300 000 Australians had accessed the internet from home.¹¹ This figure is based on four quarterly surveys conducted during 1996. The report surveyed a range of household information technology uses including computer usage, software, peripherals such as CDs, use of computer games, internet usage and competency. The 1996 Survey did not ask respondents about whether they conducted commerce over the internet although this is planned for the 1998 survey.

2.30 When the ABS report was released in November 1997, some groups, such as the Internet Industry Association, suggested that the figures were too low.¹² The figures, however, were probably highly reliable for the period when the survey was conducted in 1996. It is also important to note that the figures only cover home users.

2.31 The ranges of internet usage levels for each country, shown in Table 2.3, makes comparison more complicated. Whatever figures are used, Australia's internet penetration is about the third or fourth highest in the world. The Brussels based International Research Institutes (IRIS) ranked Australia fourth after the USA, Hong Kong and Canada for home access and fourth after the USA, Canada and Sweden for access at work.¹³ These results are consistent with Australia's second ranking for computer penetration.¹⁴

¹¹ Department of Communications and the Arts, *Submission*, p. S528.

¹² *The Weekend Australian*, 15–16 November 1997, p. 5.

¹³ Department of Communications and the Arts, *Submission*, p. S530.

¹⁴ Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, OECD, Paris, 1997, p. 74, [www.oecd.org/dsti/sti/it/ec/act/sacher.htm].

Table 2.3: Estimates of internet usage in OECD countries

| Country | Market research company | User number | Year |
|----------------|-------------------------|-----------------------------|-----------|
| Australia | ABS | 300 000 | 1996 |
| | IDC | 1 210 000 | 1997 |
| | www.consult | 1 600 000 | end 1997 |
| | AC Nielsen McNair | 3 500 000 | end 1997 |
| | New Century Group | 1 600 000 | 1997 |
| Austria | IDC | 210 000 | 1Q97 |
| | Info. Tech. Austria | 500 000 | end 1997 |
| Belgium | Nua | 200 000 | Sept 1997 |
| Canada | AC Nielsen | 8 000 000 | end 1997 |
| | Statistics Canada | 1 500 000 (households) | 1997 |
| Czech Republic | Virtual Info Park | 200 000 | Sept 1997 |
| Denmark | Carat Sweden | 600 000 | Sept 1997 |
| Finland | Taloustukimus Oy | 1 040 000 | end 1997 |
| France | Nua | 400 000 | 1997 |
| Germany | Jupiter Comm. Nua | 10% | 1997 |
| | | 4 000 000 | 1997 |
| Greece | Nua | 100 000 | end 1997 |
| Hungary | Meridian | 100 000 | Mar 1997 |
| Iceland | No data found | | |
| Ireland | Nua | 100 000 | Sept 1997 |
| Italy | ActivMedai | 1 500 000 | 2H97 |
| | Gandalf | 700 000 | 1998 |
| Japan | IDC | 1 960 000 (ISP accounts) | end 1996 |
| | IDC | 4 700 000 (OSP accounts) | end 1996 |
| | Indialine | 7 000 000 (net users) | mid 1997 |
| | NTT | 10 000 000 (net users) | end 1997 |
| | Access Media Int. | 8 840 000 (net users) | end 1997 |
| | Dataquest | 8 000 000 | end 1997 |
| | Nikkei Bus. Pubs | 7 000 000 (net users) | mid 1997 |
| | Nikkei Market Acc. | 8 600 000 | mid 1997 |

| Country | Market research company | User number | Year |
|-------------|-----------------------------------|---------------------------------------|----------|
| Korea | Inet Inc | 700 000 | Feb 1997 |
| | Asian Internet Mrkt | 700 000 | mid 1997 |
| | Korean Ministry of Infor. & Tech. | 1 550 000 | end 1997 |
| | New Century Group | 325 000 | 1997 |
| Luxembourg | No data found | | |
| Mexico | No data found | | |
| Netherlands | Nua | 1 000 000 | end 1997 |
| New Zealand | AC Nielsen McNair | 560 000 | 1998 |
| | New Century Group | 310 000 | 1997 |
| Norway | MMI Internet | 1 400 000 | end 1997 |
| Poland | Nua | 700 000 | end 1997 |
| Portugal | No data found | | |
| Spain | Estudios General de Medios | 802 000 | end 1996 |
| | AIMC | 750 000 | mid 1997 |
| | AIMC | 1 340 000 | end 1997 |
| Sweden | Infratest Burke | 630 000 | 1997 |
| Switzerland | No data found | | |
| Turkey | No data found | | |
| UK | Durlacher | 4 000 000 (excl. acad.) | 1997 |
| | Durlacher | 1 100 000 (accounts) | 1997 |
| | NOP Res. Group | 960 000 (households with accounts) | 1997 |
| | NOP Res. Group | 6 000 000 (users) | 1997 |
| | Synentia | 525 000 to 825 000 | Mar 1997 |
| US | Find/SVP | 40-45 mill | mid 1997 |
| | IDC | 29 200 000 | 1997 |
| | Intelligence | 51 000 000 | mid 1997 |
| | Intelligence | 56 000 000 | end 1997 |

Source: www.consult.

2.32 Table 2.4 shows a range of internet usage forecasts for selected OECD countries. These figures demonstrate a large degree of variation. For Australia, the internet usage forecasts for 2001 are between 4.6 and 5.3 million users. For the USA, internet use for 2000 stands at 36 million and 94.2 million for 2001 demonstrating significant variation in the forecasts.

Table 2.4: Internet usage forecasts in selected OECD countries

| Country | Market research company | User number | Year |
|-------------|------------------------------------|-------------|----------|
| Australia | IDC (with 33.4% eng in online com) | 4 670 000 | 2001 |
| | New Century Group | 5 300 000 | 2001 |
| Japan | Dataquest | 33 000 000 | 2001 |
| | IDC Japan | 18 850 000 | 1998 |
| | IDC Japan | 25 450 000 | 1999 |
| | IDC Japan | 31 950 000 | 2000 |
| Korea | Korean Ministry of Info. & Tech. | 2 500 000 | end 1998 |
| | New Century Group | 2 900 000 | 2001 |
| New Zealand | New Century Group | 740 000 | 2001 |
| UK | Durlacher | 2 600 000 | 1999 |
| | NOP Res. Group | (accounts) | 1998 |
| | | 9 000 000 | |
| | Philips Tarifica | 10 000 000 | 2001 |
| US | Synentia | 11 000 000 | 2001 |
| | IDC | 94 200 000 | 2001 |
| | Jupiter | 27 300 000 | 1998 |
| | Jupiter | 36 000 000 | 2000 |
| World | Gartner | 150 000 000 | 1998 |
| | Jupiter | 66 600 000 | 2000 |
| | Killen | 250 000 000 | 2000 |
| | IDG | 200 000 000 | 2000 |
| | IDC | 163 000 000 | 2000 |

Source: www.consult.

2.33 World internet usage figures are even more varied ranging from 66.6 to 250 million in 2000. In respect to these figures, Mr Marzbani, www.consult, commented that 'there are a lot of IT research companies that are trying to put the numbers together, but we really do not have anything that is reliable or consistent'.¹⁵

2.34 Internet growth rates serve to show the dynamic nature and growth potential of the internet. A recent government report indicated that the number of internet subscribers in recent years had been growing by about 50% a year.¹⁶ What is apparent from the statistics is that subscriber growth rates are slowing down. For 1995, 1996 and 1997, the respective internet subscriber growth rates were 250%, 100% and 50-60%.¹⁷ www.consult suggested that growth at about three to four per cent a month 'is still high compared to most other industries' and currently equates to about 20 000 new internet users a month.¹⁸

Government statistics

2.35 The development of internet commerce has created the need for high quality research and reliable data. The Committee encourages private sector internet research companies to provide accurate and timely internet statistics.

2.36 The ABS, as discussed in paragraph 2.29, has included internet usage data items as part of its survey on *Household Use Of Information Technology 1996*.

2.37 The Department of Industry, Science and Tourism (DIST), in correspondence to the inquiry, indicated its concern with the lack of contemporary and meaningful statistics in the electronic commerce and internet area. To address this lack of data, DIST commissioned www.consult to provide a quarterly data series for use by government. The first report, *stats.electronic commerce in australia, april 1998*, was released

15 Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, p. 512.

16 *Investing for Growth, The Howard Government's Plan for Australian Industry*, December 1997, p. 66.

17 Department of Communications and the Arts, *Submission*, p. S529.

18 Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, p. 513; *Transcript*, 15 December 1997, p. 418.

on 25 May 1998. The report can be downloaded from the internet at [www.dist.gov.au/html/new.html].

Conclusions

2.38 The decision by the Department of Industry, Science and Tourism (DIST) to organise the production of quarterly data statistical series is supported by the Committee. Government must be well informed of trends and patterns occurring in the internet environment. Along side this development, the Committee wishes to discuss the role of the Australian Bureau of Statistics (ABS). There is a need for the ABS to enter this field of statistics more aggressively and provide timely and accurate information.

2.39 The Committee critically examined the ABS *Household Use Of Information Technology 1996 Survey*. The results, in relation to internet usage, are clearly out of date by the time they are released and their usefulness as a decision making tool for government or business is questionable. The internet sector is highly dynamic with changes in usage and commerce levels undergoing rapid change.

2.40 The Committee asked the ABS why it was conducting a survey into internet usage only every two years. The ABS justified this situation on the basis of funding priorities commenting that 'something else would have to be given up to make way for it'.¹⁹ The Committee stresses that developments in internet commerce are occurring at a rapid rate and government must be fully briefed on these changes. Therefore, this survey should be conducted at least annually, and the results should be provided as timely as possible.

2.41 The Committee did consider whether there was also a need for the ABS to conduct a dedicated survey on internet usage and commerce. This, however, may not be necessary now that DIST is coordinating a quarterly series. The Committee, therefore, recommends that the ABS work with DIST and other government users in identifying unmet data areas where it could make a contribution. The Committee believes top priority should be given to creating an accurate and reliable internet statistical database.

19 Mr Rob Edwards, Australian Bureau of Statistics, 15 December 1997 Transcript, p. 415.

2.42 The Committee, therefore, recommends that wherever possible the ABS should introduce internet commerce and usage data items into all existing business and economic surveys.

2.43 Recommendation 1

The Australian Bureau of Statistics should:

- (a) *conduct on an annual basis the Household Use Of Information Technology Survey; and*
- (b) *wherever possible include internet commerce and usage data items into all existing business and economic surveys.*

Internet commerce

Definition

2.44 Throughout the inquiry, it was evident that 'internet commerce' and 'electronic commerce' were being used interchangeably. For example, the Australian Taxation Office (ATO) defined electronic commerce as 'the buying and selling of goods and services on the internet'.²⁰ Other sources define electronic commerce more broadly. The US Treasury states:

*Electronic commerce is the ability to perform transactions involving the exchange of goods and services between two or more parties using electronic tools and techniques.*²¹

20 Australian Taxation Office, *Tax and the Internet*, Volume 1, AGPS, Canberra, 1997, p. 12. The report can be downloaded from [www.ato.gov.au/ecp/].

21 US Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, November 1996, p. 9.

2.45 The Department of Foreign Affairs and Trade (DFAT) uses a broader definition which takes into account all forms of business activity. DFAT states:

Electronic commerce, broadly defined, is the process by which entities conduct all forms of business activity using appropriate electronic methodologies and procedures in order to achieve their organisations' objectives.²²

2.46 DFAT's definition includes a range of communication technologies such as electronic data interchange, electronic mail, facsimile transfer, phone, video conferencing and all forms of messaging between enterprises.²³ This definition takes into account much more than the movement of information over the internet. Therefore, the type of definition will influence estimates about the level of commerce transacted. The difficulties in arriving at useable definitions are discussed by www.consult:

In terms of what is in the market, there is no definition of the internet really today, or internet commerce or electronic commerce or multimedia. Everyone struggles with definitions. That is why putting numbers against them—as you will find people from the Bureau of Statistics will make clear—is a very difficult exercise all round. There is little sense of the value adding or incremental activity also in some of the definitions we see out there.²⁴

2.47 In arriving at a definition of internet commerce, it is useful to examine the component parts of commerce and then assess what should or should not be counted. www.consult suggests that the 'transaction' is 'a very small component of the internet game'.²⁵ Some of the different features of internet commerce include:

- demand generation;

22 Department of Foreign Affairs and Trade (DFAT), *Putting Australian on the New Silk Road, The Role of Trade Policy in Advancing Electronic Commerce*, National Capital Printing, Canberra, 1997, p. 45.

23 DFAT, *Putting Australian on the New Silk Road*, p. 45.

24 Mr Ramin Mazbani, www.consult, *Transcript*, 3 February 1998, p. 511.

25 Mr Ramin Mazbani, www.consult, *Transcript*, 3 February 1998, p. 515.

- advertising method — on-line, off-line, email, news distribution, search engines;
- if you haggle for your products;
- whether you need legal and management services;
- whether you want to barter, finance or distribute the products;
- the transaction;
- product support and monitoring;
- relationship management;
- service and registration; and
- through to non-electronic purchasing support.²⁶

2.48 A further issue in arriving at a definition is deciding how to deal with actions which replace those conducted by, for example, telephone, fax or personal encounter. www.consult suggests that this replacement exercise may not be significant.²⁷ What is important is a new action such as downloading computer software or music across the internet.

2.49 So in deciding on a definition, the Committee prefers internet commerce to electronic commerce. It is also clear that it is important to focus on actions and processes that are new and empower business and consumers to go beyond existing commerce.

Size and growth rates of internet commerce — Australia and OECD countries

2.50 Estimates for the current and future levels of internet commerce vary depending on the definition used. For example, DFAT reported that the current value of world wide goods and services transacted over the internet is 'around \$3 billion per year'. By the year 2000, this figure is expected to

26 Mr Ramin Mazbani, www.consult, *Transcript*, 3 February 1998, p. 515.

27 Mr Ramin Mazbani, www.consult, *Transcript*, 3 February 1998, p. 515.

increase to around US\$100 to US\$150 billion per year.²⁸ DFAT makes the point that it is difficult to calculate what proportion of this estimate is new commerce or commerce currently conducted by conventional means.

2.51 In contrast to DFAT's estimates of the value of internet commerce, DIST has provided a more conservative estimate. DIST reports that the current extent of world wide internet commerce is about US\$500 million per annum. During the next three to four years, this is expected to grow to at least US\$5 billion per year.²⁹

2.52 www.consult reports a similar level of variation. For example, Forrester research estimates that the value of US electronic commerce will amount to about \$US327 billion in the year 2002. Yet Paul Kagan Associates estimates that it will be \$US11 billion in 2007. These and other estimates are shown in Table 2.5. In evaluating these estimates, www.consult states:

...again, they are including different things in their numbers. People like Forrester, for example, start off including all the routers and equipment purchased by internet service providers within their e-commerce numbers. But I put to you that a lot of these numbers are already included somewhere else—in hardware sales by manufactures, in networking sales and telecommunications sales.³⁰

2.53 In Table 2.5, the 1997 estimate for internet commerce in Australia is based on the assumption of 250 000 Australians spending an average of \$150, for a total value of \$37.5 million. The ATO estimated that, in 1996, internet commerce in Australia was about \$10 million. During 1997, Mastercard advised, that for a 12 month period, about \$15 million worth of internet commerce had been conducted. The ATO reported estimates for 2000 of about \$4.6 billion in total internet commerce and about \$500 million in sales.³¹

28 DFAT, *Putting Australia on the New Silk Road*, p. x.

29 Department of Industry, Science and Tourism, *Submission*, p. S424.

30 Mr Ramin Mazbani, www.consult, *Transcript*, 3 February 1998, p. 512.

31 Australian Taxation Office, *Tax and the Internet*, Volume 1, p. 26.

Table 2.5: Internet commerce estimates for some OECD countries

| Country | Market research company | Estimate (billions) | Year |
|-----------|-------------------------|---------------------|------|
| Australia | www.consult | A\$0.037 | 1997 |
| | www.consult | A\$0.150 | 1998 |
| Europe | IDC | US\$1 | 1997 |
| | IDC | US\$26 | 2001 |
| | IDC (revised) | US\$31 | 2001 |
| | Forrester Research | US\$1.2 | 1998 |
| | Forrester Research | US\$64.4 | 2001 |
| Japan | Gartner Group | US\$32 | 2000 |
| US | Forrester Research | US\$8 | 1997 |
| | Forrester Research | US\$17 | 1998 |
| | Forrester Research | US\$41 | 1999 |
| | Forrester Research | US\$105 | 2000 |
| | Forrester Research | US\$183 | 2001 |
| | Forrester Research | US\$327 | 2002 |
| | IDC | US\$8.54 | 1997 |
| | IDC | US\$155.1 | 2001 |
| | Paul Kagan Associates | US\$11.7 | 2007 |
| World | IDC | US\$3 | 1996 |
| | IDC | US\$100 | 2000 |
| | IDC | US\$220 | 2001 |
| | Forrester Research | US\$2 (retail) | 1997 |
| | Forrester Research | US\$17 (retail) | 2001 |
| | ActivMedia | US\$24 | 1998 |
| | ActivMedia | US\$1,000 | 2001 |

Source: www.consult

2.54 According to a 1997 report by ActivMedia, the US accounts for 86% of world wide web-generated revenues, Canada 7%, Europe 5%, and only 1.5% from Asia. This supports other findings which indicate that most of the internet revenues and commerce originate in the United States.³²

32 www.consult.

2.55 Table 2.6 shows the percentage of internet users who are conducting internet commerce in Australia and selected OECD countries.

Table 2.6: Estimates of internet users conducting internet commerce in some OECD countries

| Country | Market research company | % of users | Year |
|-----------|---|-------------------------------|--------------------------|
| Australia | AC Nielsen McNair www.consult | 6% (population) ³³ | end-1997 |
| | | 36% | end-1997 |
| Canada | AC Nielsen | 13% | mid-1997 |
| France | Yahoo! Pan-European Audience Survey | 23% | 2Q97 (Second quarter) |
| Germany | Yahoo! Pan-European Audience Survey | 39% | 2Q97 |
| Ireland | Nua | 39% | 1997 |
| Poland | Polish World | 52% (interested) | 1996 |
| UK | Durlacher Durlacher Yahoo! Pan-European Audience Survey | 5% | 1997 |
| | | 48% (would) | 1997 |
| | | 38% | 2Q97 |
| US | CommerceNet/Nielsen Survey.Net | 15% | 1997 |
| | | 50% | mid-1997 |

Source: www.consult.

33 The AC Nielsen reference to 'population' refers to the total Australian population.

Consumer trends and patterns

2.56 Surveys show that the proportion of Australian internet users who have tried internet shopping has increased during the past two years. In December 1996, about 23% of internet users had tried online shopping.³⁴ Due to the nature of the survey in December 1996, a further breakdown is not available. In December 1997, about 43% of internet users indicated that they had tried online shopping. This figure is comprised of 22% of internet users who have tried online shopping 'more than once', 13% who have 'done it once and plan to do it again' and another 8% who had tried online shopping. In the December 1997 survey, 26% of internet users indicated that they had not tried internet shopping, but were 'willing to try it'.

2.57 The ABS, in its survey *Household Use of Information Technologies 1996*, examined willingness to use on-line services. The ABS found that, of the 13 million persons in Australia 18 years and over in 1996, 21% said yes to shopping from home and 29% said yes to banking from home.³⁵

2.58 Surveys show that certain product lines are purchased more frequently than others over the internet. This information is important for businesses wishing to have market knowledge about their products. The ATO has used this type of information to examine implications for sales tax collection. One of the key products purchased over the internet is non-educational software. Books have been the highest growing category followed by music and magazines. Some of the major products purchased over the internet in Australia at December 1997 are shown below:

| | |
|-----------------------|------|
| • other software | ≈46% |
| • books | ≈37% |
| • music | ≈25% |
| • magazines | ≈15% |
| • computer hardware | ≈14% |
| • games | ≈10% |
| • adult entertainment | ≈ 9% |

34 www.consult.

35 Australian Bureau of Statistics, *Household Use of Information Technologies, 1996*, Catalogue No. 8146, Canberra, 1997, p. 60.

| | |
|------------------------------|--------------------|
| • clothes | ≈ 9% |
| • educational software | ≈ 8% |
| • classifieds | ≈ 8% |
| • personal computer | ≈ 7% |
| • stock exchange information | ≈ 6% |
| • flowers | ≈ 6% |
| • tickets | ≈ 5% |
| • travel | ≈ 4% |
| • food | ≈ 2% |
| • wine | ≈ 1% ³⁶ |

2.59 Survey data shows that approximately 70% of annual online shopping purchases are \$70 and above. This is probably due to the impact of shipping or postal costs. Low value goods will not achieve significant cost savings once postal costs are added. In the last three years, the greatest increase in the value of goods and service purchased has been in the \$151 to \$500 category.³⁷ Internet users who have shopped online 'more than once' are much more likely to spend larger dollar values online over 12 months.

2.60 An examination of spending levels by product reveals that the \$1001 or more category consists of computer hardware (29%), travel tickets (26%) and other computer hardware, excluding PCs (24%).³⁸

2.61 The reasons for shopping on-line are not primarily to save money. For those internet users who have tried internet shopping more than once, the major reasons for doing so include:

| | |
|---------------------------------------|------------------|
| • to buy things not locally available | 41% |
| • to save money | 15% |
| • to get a better selection | 5% |
| • to shop after hours | 3% |
| • to get it faster | 3% |
| • prefer not going to the store | 3% ³⁹ |

36 www.consult.

37 www.consult.

38 www.consult.

39 www.consult.

2.62 The motivation 'to save money' is a third the size of responses given for buying goods not locally available. This can be interpreted in a number of ways. Mr Ramin Marzbani, of www.consult, suggests that the low response for saving money indicates that consumers are not, solely, involved in internet commerce 'just to avoid tax'.⁴⁰

Case study – buying books and CDs over the internet

2.63 The economics of buying goods over the internet introduces additional considerations that would not apply with a conventional across the counter transaction. Certain conditions are assumed such as ownership or access to a computer with internet access. If an item is located in another country then waiting times, postal costs and possibly duty and sales tax will apply. The following examples show how these costs apply to the purchase of books and CDs. No sales tax applies to the purchase of books.

2.64 www.consult priced the top five selling books at Dymocks. These prices were then compared to what was available from Amazon.com, a major internet bookseller located in the US. After currency conversions, there was an apparent price saving of between 20 to 31%. Shipping costs, however, change this result. Surface mail is the cheapest at \$4 plus \$1.95 per book but takes about 10 to 12 weeks for delivery. World mail costs \$7 plus \$5.95 per book and takes from 7 to 21 days. DHL express costs \$30 plus \$5.95 per book and takes 1 to 4 days. www.consult calculated that to order one book by DHL express and break even, it would need to cost at least \$US140. Savings would increase as more books were ordered as economies of scale would be achieved with freight costs.⁴¹

2.65 A similar situation arises for CDs. If one CD is bought from CD Now, a major internet music retailer in the US, shipping costs become more than 50% of the invoice cost. As more CDs are purchased, the shipping costs come down to about 20% of invoice cost. www.consult estimates that when purchasing between 3 to 8 CDs the average price of a CD

40 Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, p. 517.

41 Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, p. 518.

comes down to less than A\$25. Currently, CDs retail in Australia at about \$30. When the buyer approaches 8 CDs, then they start to exceed the Australian duty and sales tax free limit of \$50. The ability to download music electronically and record it on to a blank CD will avoid the need to pay shipping costs, although at current internet access costs and speeds, this would still be an expensive and slow process.

2.66 These results tend to support the survey findings that consumers are more likely to purchase an item using the internet because it is not available locally, rather than to save money.

Business to business commerce

2.67 In examining internet commerce it is important to discriminate between business to business and business to consumer commerce. DoCA suggests that business to business transactions will dominate internet commerce and grow at a faster rate. DoCA indicates that consumer take-up is slower and confined to certain demographic groups. The Internet Industry Association made a similar observation:

The consumer driven electronic commerce is not going to be the most significant factor in this equation. Our projections are that, in the next two to three years, up to 80 per cent of electronic commerce will simply be business to business commerce. It will be the transactions of business between suppliers, retailers, wholesalers and distributors in exactly the same kind of format they are using now, but with a global market. They can transact it much more simply and straightforwardly over the Internet, whether it is a private Internet or whether it is a public Internet.⁴²

2.68 Others, such as www.consult, suggest that business to business transactions are likely to slowly substitute existing processes such as telephone, fax and electronic data interchange (EDI). However, without a major change in technologies and the re-engineering of business processes within small to medium sized enterprises, the major benefits of electronic business to business commerce will be limited to low-level productivity gains. www.consult believes that there

42 Michael Ward, Internet Industry Association, *Transcript*, 5 November 1997, p. 170.

are, however, many industries and sub-industries which could greatly benefit from automating business to business communications and transactions, but only if a significant number of participants in that industry decide to change at the same time.

2.69 It is also likely that business to business electronic commerce may lead to the development of new business models, ranging from co-operative and reciprocal online advertising to a broad range of information sharing applications.

Summary of key Australian internet statistics

2.70 Current estimates suggest that there are between 500 000 and 4 million internet users in Australia depending on different research reports and different measurement criteria. According to www.consult there were some 1 million regular internet users accessing the web once a week or more frequently in Australia in January 1998, although there were some 600 000 other less regular users. There are also an additional 500 000 email users with the ability to send and receive email over the internet. The cost of internet access for dial-up users continues to fall significantly, having come down from \$5 per hour in September 1995 to \$2.47 per hour for casual use in January 1998. The average cost of internet access from the various packages available in Australia now stands at \$1.21 per hour.

2.71 The use of the internet is currently limited to a narrow demographic population profile with higher levels of income and education. There are many different projects at State and Federal levels aiming to expand access to the internet through educational and community institutions as well as public access kiosks. However, the cost of purchasing a personal computer is still not low enough and less than half the population have a personal computer at home with a smaller proportion owning modems or computers capable of accessing the internet.

2.72 There are also some 15 000 enterprises, consisting of both business and government, with a permanent access to the internet⁴³. These enterprises provide some or all of their employees with access to the internet from their desktops without the need to dial into the internet. The cost of permanent access to the internet in Australia is currently much higher than the United States and although not dissimilar to other countries in the region, it is a potential source of competitive disadvantage.

2.73 In January 1998, there were some 54 800 enterprise websites in Australia, although only 21 600 were hosted in an on-line shopping mall or were part of a directory or listing service. The number of enterprise websites continues to grow at the rate of some 50 to 100 per day.⁴⁴

2.74 The complexities of integrating internet access and services into an enterprise are significant and medium-sized enterprises face larger hurdles than large enterprises or very small enterprises because of the fixed costs associated with the introduction and integration of the internet into the business. It is likely that enterprise adoption will be somewhat slower than earlier predictions because of the time and resources required to properly develop internet business strategies and implementation plans, as well as the justification of the costs.

2.75 According to *www.consult's* April 1998 IAP Report, there are some 632 Internet Service Providers (ISPs) in Australia, supporting the use of the internet. The number of ISPs has continued to increase indicating strong demand for internet access services and good coverage in both metropolitan and rural areas, at least in locations where the telephony infrastructure supports the use of modems.

43 *www.consult, IAP Report*, April 1998.

44 *www.consult, Web Hosting Report*, February 1998. The number of enterprise websites in Australia was determined through a combination of: responses in the enterprise survey of 1 000 enterprises randomly selected; the number of new enterprise domains registered and being registered; and a 'whole of market' survey of ISPs (the *Web Hosting Report*).

2.76 In addition, there are currently some 1 050 web developers in Australia providing different types of service and support to enable the development, management and maintenance of internet websites and web services.⁴⁵

2.77 Overall, Australia appears to be well positioned from the point of view of infrastructure services, and competitive commercial interests are driving internet and electronic use and adoption. It is likely that enterprise adoption will vary by industry, business size, market competition and market opportunities.

45 *www.consult, Australian Web Developers Directory*, February 1998.

INTERNET COMMERCE AND TAXATION

Introduction

3.1 The rise of internet commerce will present a range of challenges for tax administrations. The internet will transcend state and national borders and commerce will be global in every sense. Small and medium enterprises (SMEs), and more consumers than ever before, will have the opportunity to buy and sell goods internationally.

3.2 Some of these goods and services will be downloaded electronically and the entire transaction will be protected by a sophisticated encryption system. In this case the first challenge for the tax administrator is to identify that a transaction has occurred and in what jurisdiction. The next task is to assess whether tax should be applied and how it should be paid.

3.3 Internet commerce requires an international approach to taxation. For example, a business entity may be located in one country, have its web server in another country and then direct payments and other revenue to off-shore banking facilities and tax havens. What is most significant about this scenario is that it will be relatively cheap to do and potentially a wide range of people and SMEs could plan their affairs in this way. Tax administrations will have difficulty in determining and exercising tax jurisdiction. These are some of the reasons why tax administrations around the world are giving serious attention to the various implications of internet commerce.

3.4 The solutions to administering taxation in an internet environment are to be found in international consultation and agreement. Currently, more than twelve member countries of the Organisation for Economic Co-operation and Development (OECD) have committees or inquiries looking into the implications of tax and the internet. The US and Australia have released detailed discussion

papers. The Committee on Fiscal Affairs (CFA), the main tax body of the OECD, is also researching the challenges for tax administrations in managing internet commerce.

3.5 This Chapter will review some of the major issues arising for tax administrations from internet commerce, and also discuss possible government responses. The complexity and international dimensions of the issues suggest that it is not feasible for countries to take unilateral action on taxation matters associated with internet commerce.

Internet commerce and tax administration

3.6 In assessing the impact of internet commerce on tax administration, it is helpful to examine some of the possible business and consumer opportunities that could arise through this new form of commerce.

3.7 The key feature of internet commerce is the significant power it provides to business and consumers at relatively small cost. The ability to trade internationally and funnel revenue around the globe was once the province of large multi-national corporations. The internet has changed this. The OECD states:

Start up capital requirements on the internet are typically low and the internet gives enterprises the ability to access an inexpensive global communication system, through which goods and services can be advertised, sold, and possibly delivered. Small and medium enterprises will find it easier to engage in international commerce. This, in turn, will lead to a rapid expansion in cross-border activities. Access for small and medium enterprises is easier because the internet reduces the need for intermediaries in the sale and delivery of goods and services.¹

3.8 Internet commerce offers scope for efficiency improvements particularly in the distribution process. For example, a consumer will be able to purchase goods and services direct from the producer thereby cutting out

1 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, November 1997, pp. 5-6.

intermediaries. This is called disintermediation and while it might offer efficiency improvements for business, it creates problems for taxation administration because there are fewer taxing points.

3.9 In conducting internet commerce, consumers and business will need to ensure that transactions are protected against interception and misuse. This need will give rise to the use of powerful encryption devices. While encryption is a legitimate need for business and the consumer, it creates a range of problems for tax administrations. Owens states:

The development of encrypted information may mean, furthermore, that governments have no access to the content of messages sent on the net, they will neither know what type of transaction is taking place nor be able to assess its value for taxation.²

3.10 The benefits of encryption for internet commerce and the opposing needs of legitimate law enforcement and taxation were discussed in the Sacher Report.³ This report suggested that the use of encryption is vital to realising the full potential of internet commerce. The report stated that 'no country should be able to enforce national encryption policies on firms in other countries as a condition of market entry, and encryption policies should not be adopted that operate to the disadvantage of the honest trader'.⁴ Encryption issues are discussed in more detail in Chapter 7.

3.11 In summing up, the internet provides business with the opportunity to trade globally and to do so with high levels of secrecy. At the same time, the volume of cross-border transactions could increase significantly. Business will be able to gain further advantages based on the way they communicate and organise their activities which, again, could have implications for taxation. Business, for example, could locate and operate a webshop from a location which best serves its business interests. The following hypothetical scenario shows what could occur:

2 Owens, J., 'What Chance the Virtual Taxman', *The OECD Observer*, No. 208, October/November 1997, p. 17.

3 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, OECD, Paris, 1997, p. 14.

4 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 14.

- An Australian organisation, Acme Pty Ltd, set up a Webshop by having a US-based ISP host it. Acme is enticed there because of the comparatively low cost of establishing and maintaining a Webshop.
- Acme advertises books and has an extensive on-line catalogue.
- Acme's e-commerce software accesses several backend databases belonging to different publishers. These databases are located in New York, London, and Sydney.
- The publishers have arrangements in place with DHL to deliver books all over the world.
- Acme accepts payment by means of Mastercard and Visa. Mastercard issues invoices to its participating banks from its new SE Asian headquarters in Malaysia. The participating banks, in turn, issue statements to their card-holders.
- The books advertised by Acme are located in several third party warehouses around the world including Amsterdam, Singapore, and New York. Acme does not have its own warehouse: it is purely a Webshop. An order placed with Acme is relayed to the warehouse, where shipment is arranged through DHL.⁵

3.12 The previous example was prepared by the Commonwealth Scientific and Industrial Research Organisation (CSIRO) for the purpose of showing the multiple transaction paths across different tax jurisdictions that could occur in the sale of a book. The CSIRO suggested that if 'Acme' was being investigated by the Australian Taxation Office (ATO) and the US Internal Revenue Service was cooperating under a double taxation agreement, then Acme could move its Webshop, overnight, to a country that has no such agreement with the ATO.

5 McRea, P. and Smart, B., 'The Internet Report', in *Tax and the Internet*, Volume 2, AGPS, Canberra, p. 16.

Implications for tax administration

3.13 The following issues affect taxation:

- location of activity;
- identification;
- disintermediation;
- electronic payment systems;
- tax havens and off-shore banking facilities;
- electronic records; and
- domination by large corporations.

Location of activity

3.14 When consumers are using the internet to buy goods and services, the webshops they access can be located throughout the world. The Sacher Report commented that 'the nature of the system is such that it has no physical location'.⁶ The consumer's objective is to seek out the good that they want and then decide to make a purchase based on price and, if necessary, freight. For the consumer, the location of the webshop is not important. For taxing administrations, the location of a webshop is essential for determining where a commercial activity is carried out.

Identification

3.15 Identifying the parties to an internet transaction may, in some cases, be difficult to determine. The Sacher Report suggests that it may be impossible to identify the owner of a website conducting internet commerce.⁷ The ATO discusses some of the implications this will have for taxation:

A key issue will be the extent to which the internet will allow business activities to be undetectable or anonymous, so that the key taxing and auditing requirements of the existence and identity of persons or transactions cannot be determined. A high level of non-detection could lead to tax

6 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 6.

7 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 13.

*evasion in a highly competitive global business environment where business may be forced to adopt non-compliance facilities to compete with other businesses, thus exacerbating non-compliance.*⁸

3.16 The Sacher Report, in addressing the issues of identification, commented that 'identification and registration requirements will have limited success with the growing ease with which websites can be located offshore'.⁹ The ATO concluded that it 'will be impossible to detect or determine internet activity without some form of regulation'.¹⁰

Disintermediation

3.17 Disintermediation is the elimination of 'middlemen' in the production and distribution chain. This has two key implications. First, 'middlemen' such as importers and distributors provide useful tax collection and data gathering points and therefore allow tax administrators to cross-check information. This situation also applies to financial institutions which may be eliminated in some transactions. Second, if there are fewer 'middlemen' then tax administrations will be forced to collect smaller amounts of revenue from a larger number of taxpayers, raising the cost of collection. The ATO states:

*The enforcement implications of disintermediation are significant. The practicalities of enforcing sales tax and customs duty differ considerably between the case of a container load of goods imported via a registered importer/wholesaler on the one hand, and several thousand end users who have ordered goods from overseas websites because of cheaper prices on the other.*¹¹

8 Australian Taxation Office, *Tax and the Internet*, AGPS, Canberra, 1997, p. 53. The report can be downloaded from [www.ato.gov.au/ecp/].

9 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 13.

10 Australian Taxation Office, *Tax and the Internet*, p. 53.

11 Australian Taxation Office, *Tax and the Internet*, p. 56.

Electronic payment systems

3.18 A necessary part of internet commerce will be reliable and secure electronic payment systems. These payment systems may partly displace existing payment systems such as cash and cheques. Electronic payment systems could include stored value cards, enhanced credit card systems and network money. Payment systems will either be accounted or unaccounted. Accounted systems require the inclusion of a third party which ensures that a record of the transaction is kept. Accounted systems are unlikely to present problems for tax administrations.¹²

3.19 Unaccounted electronic systems eliminate the need for an independent third party and are therefore essentially the same as a cash transaction. The one difference, in the view of the ATO, is that electronic cash will be 'more challenging' than physical cash, the latter being hand to hand whereas the former is global. The OECD's Committee on Fiscal Affairs indicated that it is studying how techniques developed for reducing tax evasion for physical cash can be adapted for electronic money.¹³ The ATO concluded, that 'regulations imposed on electronic money by Australia acting alone would have limited effectiveness and could even be harmful'.¹⁴ A further feature of electronic money is that it can assist in using offshore banking facilities and tax havens.

Tax havens and off-shore banking facilities

3.20 Australian banks are steadily providing a range of internet banking services. Ultimately, a customer will be able to perform over the internet the full range of banking services, including opening accounts, that they are now performing through conventional methods. Once this power becomes available, then people from other countries should be able to do the same. At the same time, Australians will have

12 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 10.

13 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 10.

14 Australian Taxation Office, *Tax and the Internet*, p. 24.

the opportunity to use offshore banking facilities. For the potential tax evader, 'the optimal bank is one that is at least as accessible and well-run as any local institution, but that remains beyond the reach of the domestic tax authority'.¹⁵

3.21 While tax havens and off-shore banking facilities have been available in the past, there are two critical developments that will raise their importance for tax administrations. First, is the potential for these facilities to become more sophisticated offering better access, anonymity and security. Second, is that the internet will allow increased access. Warren states:

*For tax evasion to be successful, the complicity of countries prepared to set themselves up as tax havens is fundamental. This complicity must extend to providing a low or zero tax regime for all internet commerce. This must extend to internet businesses and internet banks which deal with internet commercial transactions. The banking system has an important role in facilitating the laundering of any profits made back into the country where the real owner of the commercial website resides. While tax havens have always been with us, what is different now is that the internet makes them accessible to the masses. With bank secrecy ensured in the tax haven, everyone has the potential to participate in large scale tax evasion.*¹⁶

3.22 In November 1997, the Australian Commissioner of Taxation, Mr Michael Carmody, announced that the subject of tax havens and bank secrecy in administering Australia's tax system would form the topic for the inaugural Commissioner's Award for Research in Taxation. Entries close on 30 September 1998 and the prize for the winning entry is \$20 000. Mr Carmody stated:

Tax administrators face greater difficulties in enforcing tax laws and maintaining their community's legitimate revenue base when dealing with international rather than domestic transactions, particularly when dealing with a jurisdiction that combines tax haven status with bank secrecy.

15 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 10.

16 Warren, N., *Tax and the Internet: An International Perspective*, Paper presented at ATO conference, Sydney, 12 November 1997, p. 14.

*Increasingly, tax haven regimes with bank secrecy laws in place are accessible to almost anyone with a modem and a computer.*¹⁷

3.23 A related issue to the operation of tax havens is tax competition. The ATO identified this as a threat that could evolve as internet commerce opens up more trade with the consequent opportunity for countries to compete on the basis of taxation levels. The ATO commented that 'some countries will perceive that their comparative advantage is from standing out of the ruck and actually competing on taxation'.¹⁸

Electronic records

3.24 In 'physical' commerce, where accounted systems are used, paper trails are kept of transactions. Financial documents are important for auditing purposes and may be examined by tax authorities. Further, it is difficult to alter these records without leaving evidence. With electronic records, there is more opportunity for people to alter them, or keep them completely encrypted. The ATO commented on the implications that electronic records will have for tax administration:

*Electronic commerce challenges the underlying presumptions that records of Australian taxpayers will be created and held within Australia. To the extent that records are held outside of Australia, and are not readily accessible, the effectiveness of tax administration is reduced.*¹⁹

17 Mr Michael Carmody, Commissioner of Taxation, *Australian Taxation Office Media Release*, Nat 97/59, 11 November 1997, [www.ato.gov.au/ecp/].

18 Mr Jim Killaly, *Australian Taxation Office Transcript*, 3 February 1998, p. 547; Mr Michael Carmody, *Australian Taxation Office, Transcript*, 15 December 1997, p. 368.

19 Australian Taxation Office, *Tax and the Internet*, p. 54.

Domination by large corporations

3.25 The ATO received advice from the Online Media Program (OMP), La Trobe University, that a mature internet commerce market could be dominated by a small number of large corporations. The OMP stated:

...we see electronic commerce leading to massification, where a small number of very large players will dominate an industry sector and a large number of small players will compete for the rest of the market through differentiation and specialisation. This 'whales' and 'minnows' scenario means that the ATO will be dealing with a small number of large organisations which will account for the bulk of any one market, and a large number of small enterprises. On balance, we imagine that this would aid in the collection of taxation revenue.²⁰

3.26 This view was reflected in Finding 8 of the ATO report, *Tax and the Internet*. The ATO agreed that 'massification' of business could assist tax collection. The ATO commented that 'a more focused compliance effort is possible with a few large corporations, even if non-compliant, than many small ones.' The ATO, however, indicated that where these large corporations were outside Australia then there will be little that it 'can do to properly administer the tax law in relation to these parties without effective international co-operation'.²¹

Source, residence and permanent establishment

3.27 The previous sections discussed some of the features of internet commerce that could create significant challenges for tax administration. Issues of location, identification, encryption and electronic records are the first tests that tax administrations must overcome in being able to assess whether tax is due and how much. Once tax administrations have got beyond this point, they are likely to need to share taxation revenue with other tax jurisdictions. Traditional

20 Australian Taxation Office, *Tax and the Internet*, Volume 2, Article 1, p. 21.

21 Australian Taxation Office, *Tax and the Internet*, p. 83.

taxation principles and agreements for sharing taxation revenue, however, are also affected by internet commerce. The key principles that require discussion are source, residence and permanent establishment.

3.28 Permanent establishment is described in Article 5 of the OECD Model Tax Convention as a 'fixed place of business through which the business of an enterprise is wholly or partly carried on'.²² Permanent establishment helps to provide a high threshold for determining a company's business income tax liability in a country. A permanent establishment is defined to include a place of management, a branch, an office, a factory or a workshop. The OECD commented that the 'permanent establishment concept is rooted in physical presence in the country where economic activity occurs and developments in communications technology raise a number of questions regarding its scope'.²³

3.29 It is not clear whether a website constitutes permanent establishment. A website can be highly mobile and exist in a country without any employees existing in that country. For example, does a website satisfy the criteria of 'fixed place of business'? Warren argues that this would be difficult to prove:

Does a website have a permanent physical presence? If it does it can be extremely elusive. Such sites can be moved, replicated and masked with considerable ease. After all, these electronic establishments are nothing more than binary code stored on some electronic retrieval device (a computer). It therefore, makes something of a mockery of the concept of a permanent establishment.²⁴

3.30 Determining permanent establishment has implications for the other key taxing principles of source and residency. For example, a non-resident can generally only be taxed in the source country on business profits if the income earned is attributable to a permanent establishment in that country. The OECD defines source and residency as:

22 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 24.

23 OECD, *Implications of the Communications Revolution for Tax Policy and Administration*, CFA(96)46, June 1996, p. 20.

24 Warren, N., *Tax and the Internet: An International Perspective*, p. 12.

*...the country of residence is best thought of as the place with which a taxpayer has the closest personal links. The country of source is the country with which income has its closest economic connection.*²⁵

3.31 In general, under source and residence rules, Australian residents are taxable on their world-wide income, while non residents are taxable only on their Australian sourced income.²⁶ There is a debate about whether source and residency concepts are still appropriate in an internet commerce environment, or whether one of these concepts alone is more relevant. The ATO states:

*Capital exporters tend to push the pre-eminence of residents' country taxing rights. Capital importers, since their contribution is actually taking that capital and employing it in some productive capacity, tend to focus on source country taxing rights and argue for ascendancy of that particular head of taxation right. In the international context we have to strike a balance between those two taxing rights, and it is primarily looking at the positions of net capital exporters and net capital importers.*²⁷

3.32 The US asserts that residency based taxation will assume greater importance in the future. The US Treasury states:

*In the world of cyberspace, it is often difficult, if not impossible, to apply traditional source concepts to link an item of income with a specific geographical location. Therefore, source based taxation could lose its rationale and be rendered obsolete by electronic commerce. By contrast, almost all taxpayers are resident somewhere. An individual is almost always a citizen or resident of a given country and, at least under US law, all corporations must be established under the laws of a given jurisdiction.*²⁸

25 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 22.

26 Australian Taxation Office, *Submission*, p. S467.

27 Mr Jim Killaly, Australian Taxation Office *Transcript*, 3 February 1998, p. 527.

28 US Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, November 1996, p. 26, [www.ustreas.gov/treasury/tax/internet.html].

3.33 The US preference for residency concepts over source concepts has been questioned. Mr Paul McNab, in evidence to the inquiry, points out that the US is predominantly an exporter of goods and services and will benefit from a taxation system based on residency concepts.²⁹ Similarly, *Taxation in Australia* suggests the US favours residency concepts because 'it has the lion's share of resident multinationals'. The journal article stated that the US policy 'primarily serves to protect the interests of American companies and the US revenue'.³⁰ The editorial team of *Taxation in Australia* suggested that as the US is the most influential member of the OECD, the US preference for residency concepts is a likely indicator of the direction the OECD will take.

3.34 The OECD, in a discussion paper for a meeting in Turku, Finland during November 1997, discussed source and residence concepts. The paper commented that 'there are good administrative reasons for adopting these twin standards' of source and residency. Further in the discussion, the paper stated:

...a country will be most successful in the collection of revenue in the international context if it focuses its enforcement activities on persons or economic transactions connected with the country.

3.35 The Sacher Report supports 'approaches to taxation based on principles relating to the source and destination of products, be they tangible or intangible, and of residency of companies'.³¹

3.36 The ATO has addressed the issue of residency and source. In *Tax and the Internet*, the ATO stressed its concern with the US preference for residency based taxation and

29 Mr Paul McNab, *Submission*, p. S168.

30 'Inside the OECD: Internet Indecision', *Taxation in Australia*, Volume 5, Number 4, April 1997, p. 174.

31 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 17.

claimed that both residency and source principals were equally at risk. The ATO, in a submission to the inquiry, stated:

...a more fundamental issue which the ATO has been active in pressing at the OECD is whether, in the context of electronic commerce, it is still appropriate to measure economic presence by reference to physical factors such as fixed place of business. If the measure of economic presence is not adapted to the new environment, then countries such as Australia which are net importers of the technology may stand to lose substantial revenue as a result of a shift from source to residence based taxation.³²

Taxation sharing options

3.37 Evidence was received on three taxation sharing options which go beyond source, residency and permanent establishment. The first, suggested by Richard Vann³³, proposes that there be 'a shift to a multi-lateral international tax base where transactions within a group are eliminated and the international tax base is divided between jurisdictions using a formulary method'.³⁴ Under this method, 'each country would apply a single tax rate to its portion of the tax base subject to any ceiling rate to which it had agreed multi-laterally and the residence country would then tax or not, as it saw fit, the foreign income, subject to the rules against double taxation'.³⁵ The key point about Vann's proposal is that it can only be conducted at a multi-lateral level. McNab states:

...Vann argues that multi-lateralism will not simply arise by evolution from the bilateral OECD framework. This is because of the enormous diversity of the details of income tax systems around the world. Although it is possible to bilaterally solve most conflicts between two tax systems at

32 Australian Taxation Office, *Submission*, p. S467.

33 Vann, R., 'A Model Tax Treaty for the Asian - Pacific Region? (Part 1)', *International Bureau of Fiscal Documentation Bulletin*, March 1991;
Vann, R., 'A Model Tax Treaty for the Asian - Pacific Region? (Part 2)', *International Bureau of Fiscal Documentation Bulletin*, April 1991.

34 Mr Paul McNab, *Submission*, p. S404.

35 Mr Paul McNab, *Submission*, p. S404.

their interface, it is generally considered impossible to secure agreement multilaterally on the many specifics arising from tax systems' diversity.³⁶

3.38 Vann argues that an international tax institution is needed 'with powers that cede some national tax sovereignty to the international level'.³⁷ McNab identified some of the benefits of Vann's multi-lateral taxation sharing option:

- **the schedular structure of tax treaties** — tax treaties apply different tax regimes to different types of income and create biases in taxpayers' economic behaviour. Inefficiencies arise as taxpayers seek to achieve the best tax result by manipulating the categorical treatment of different types of income. Formulary apportionment does not involve any schedular structure;
- **tax reciprocity** — tax treaties contain clauses stating that tax rates will be reciprocal. Where treaty partners operate different tax systems with respect to the same type of income (eg classical v imputation on dividends), tax rate reciprocity can cause inefficiency. An international tax base eliminates any need for tax reciprocity;
- **the arm's length criterion for transfer pricing** — the growth in intangibles combined with the capacity for instantaneous communication and electronic delivery on a global scale, means that enforcement of the arm's length criterion within groups is becoming increasingly difficult. Consolidation of group companies and formulary apportionment of worldwide income removes the administrative difficulties involved in complying with and enforcing the arm's length principle;
- **the effectiveness of treaty concepts in dealing with emerging ways of conducting business** — an obvious example of significance for Australia is the concept of a 'permanent establishment' (PE). The prospect that the concept of PE will not grant source countries the right to tax profits generated

36 Mr Paul McNab, *Submission*, p. S404.

37 Mr Paul McNab, *Submission*, p. S404.

from internet and other electronic transactions could see a major shift of taxing rights to residence countries. This is most significant in the context of Australia's global trade position. Formulary apportionment of worldwide income is not affected by changes in the way we conduct business; and

- **inflexibility** — there is currently a bilateral network of over 1000 treaties. This presents a significant barrier to any new initiative that is adopted in relation to terms of the OECD Model. An international tax institution represented by members of the various signatories would provide much greater flexibility with respect to making changes to the operation of the system.³⁸

3.39 Some of the disadvantages of Vann's proposal include the difficulty of reaching multilateral agreement on the definition of the tax base, and the selection of an appropriate basis for the formulary method. Further obstacles may arise through transnational corporate groups manipulating the grouping rules, and countries remaining outside the system. On this last point, McNab states:

*...it would be necessary for the system to ultimately include the major trading nations so as to achieve the necessary level of international consolidation and the coherence that it brings. Tax havens may not threaten the integrity of the system as definition of residence and the nature of the system can be designed to combat such competition.*³⁹

3.40 A variant of Vann's multilateral agreement model is to have a multi-lateral agreement to apportion tax but without an international tax institution. This is achieved through unitary taxation which is the practice of taking the world wide profits of a corporate group and assigning a proportion of that income to the taxing jurisdiction by application of an agreed formula.⁴⁰

3.41 A second taxation option discussed by McNab, is unilateral action by Australia, or other countries, in amending parts of international agreements which are dependent on

38 Mr Paul McNab, *Submission*, pp. S404-405.

39 Mr Paul McNab, *Submission*, p. S406.

40 Mr Paul McNab, *Submission*, p. S406.

local law for their meaning. McNab suggests, however, that there are only a limited number of terms or concepts which could be the subject of unilateral action. McNab concludes that 'there is only a limited amount of protection that such action could provide.'⁴¹ In addition, unilateral action could create disincentives for foreigners to deal with Australia.

3.42 Third, is the proposal of a 'bit tax' which involves taxing each bit of digital information flowing across global networks. The US is opposed to the idea of a bit tax. Similarly, the EC has rejected a bit tax because, in its situation, 'VAT [value added tax] already applies to these transactions'.⁴² The Australian Government has ruled out the use of a bit tax.⁴³

Double taxation agreements

3.43 Taxation treaties are mostly bi-lateral and are designed to ensure 'the avoidance of double taxation and the prevention of fiscal evasion'.⁴⁴ The OECD indicates that there are in excess of 1500 tax treaties and the number is growing rapidly. With respect to the tax evasion potential, the OECD states:

*The prevention of tax evasion primarily refers to cases where taxpayers fraudulently conceal income in an international setting and rely on the inability of tax administrations to obtain information about income from foreign sources. The exchange of information article in tax treaties is the major provision dealing with this problem.*⁴⁵

3.44 The ATO agreed that double taxation agreements (DTAs) can facilitate the provision of information from foreign jurisdictions. The ATO, however, warned that DTAs as they are currently structured 'would not provide direct support for

41 Mr Paul McNab, *Submission*, p. S410.

42 Commission of European Communities, *A European Initiative in Electronic Commerce*, April 1997, paragraph 57.

43 *Investing for Growth, The Howard Government's Plan for Australian Industry*, December 1997, p. 65.

44 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 23.

45 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 23.

the collection of taxes or for reliable identification of taxpayers where the other jurisdiction does not have rigorous taxpayer identification arrangements'.⁴⁶

3.45 The risk of double taxation was raised in Arthur Andersen's *Convergence and Global Tax Issues Forum* in March 1997. Some concerns were raised about how modern electronic business structures would operate within existing tax laws. With respect to double taxation, the Arthur Andersen forum recognised:

*...significant risks of double taxation because of conflicting interpretations among tax jurisdictions of how income should be sourced, characterised and priced.*⁴⁷

Conclusions

3.46 Taxation concepts such as source, residency and permanent establishment help to create a legal basis for tax jurisdiction. The onset of internet commerce will complicate the application and interpretation of these principals. The US has announced, through a US Treasury Paper, that source concepts could lose relevance and be replaced with residency as the major taxing concept.

3.47 Key issue

The Committee is yet to be convinced that the US preference for residency principles is either in Australia's best interests as a taxation formula or that it is an inevitable development. More time, research and international consultation is needed to explore how existing taxation concepts are interpreted and applied.

3.48 The Australian Taxation Office (ATO) suggested that 'geographical concepts of jurisdiction will erode' in an internet environment. Internet commerce is not restricted by national borders. Webshops can be easily moved and positioned in another country thereby complicating assessment of tax jurisdiction. In addition, there will be difficulties in applying the concept of central management and

46 Australian Taxation Office, *Tax and the Internet*, p. 61.

47 Arthur Andersen, *Electronic Commerce Report*, November 1997, p. 5.

control. That is, the internet will provide greater opportunities to manage offshore subsidiaries. With this situation, it would be difficult to determine where such a business was carried on. Therefore, the Committee supports the ATO in its conclusion that both source and residency concepts will equally be at risk in an internet environment.

3.49 Key issue

Other OECD countries should critically review the applicability of existing taxation concepts such as source and residency and consider whether these concepts can be adapted to the internet environment.

3.50 The Committee has given consideration to three taxation sharing options. A bit tax is rejected and the Committee supports the Government's stated position on this matter. Unilateral action on taxation matters would be unwise. One of the key themes of this report is that the highly dynamic nature of internet commerce demands caution in policy making. A major part of achieving workable and effective outcomes to govern international taxation is international consultation and agreement.

3.51 The Committee reviewed some of the advantages and disadvantages of Richard Vann's proposal for a multi-lateral agreement to apportion tax. The Committee accepts the theoretical attractiveness of Vann's proposal. It removes the problems created by tax competition, avoids inefficiencies created by tax rate reciprocity, removes the administrative difficulties involved in complying with and enforcing the arm's length principle, and avoids the need to rely on geographical concepts, such as source and residency, for taxation sharing.

3.52 At the same time, the Committee notes that there are disadvantages with Vann's proposal. First, it is going to be an extremely difficult and lengthy process to move away from bilateral agreements and achieve a multi-lateral agreement. Second, problems may be created by countries remaining outside the system. The Committee believes that the true merits of a multi-lateral agreement to apportion tax will only become attractive once internet commerce begins to reach its full potential and countries' taxation bases are affected. In this event, the disadvantages of Vann's proposal could become less of an obstacle and there will be considerable incentive to achieve a workable outcome to international

taxation sharing. The Committee does not rule out the possibility of a multi-lateral agreement to apportion tax, and encourages the ATO to raise this type of option at international forums.

Transfer pricing

3.53 Transfer pricing is the establishment for tax purposes of appropriate prices at which an enterprise transfers goods and intangible property or provides services to associated enterprises.⁴⁸ The OECD states:

*Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions.*⁴⁹

3.54 The 'arm's length principle' is the international standard that OECD countries have agreed should be used for determining transfer prices for tax purposes. Determining arm's length prices requires the use of certain methodologies. The Australian Master Tax Guide states:

*There are a number of internationally accepted arm's length methodologies, all of which are based on the concept of comparability — comparing the prices/margins achieved by associated enterprises in their dealings with each other to those achieved by independent enterprises for the same or similar dealings. Taxpayers should utilise the method which produces the highest practicable degree of comparability. The standard of comparability that is practicable will be determined by how much reliable data is available to make comparisons with uncontrolled situations.*⁵⁰

3.55 Abuse of transfer pricing is often the method by which multi-national companies minimise the payment of tariffs or shift profit from a high taxation country to a low taxation country. The application of transfer pricing is

48 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, August 1997, P-3.

49 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, P-4.

50 1997 Australian Master Tax Guide, CCH Australia Limited, 28th Edition, p. 1303.

complicated and the possible implications of internet commerce are being examined. The OECD warns that transfer pricing problems could become more common:

*To date the communications revolution presents neither fundamentally new nor categorically different problems for transfer pricing. However, the emergence and growth of electronic commerce has the potential to make some of the more difficult transfer pricing problems more common...electronic commerce and the development of internal private networks within Multi-national enterprises may be seen as putting pressure on the traditional approach taken to deal with non-arm's length transfer pricing even though the basic nature of the problem has not changed.*⁵¹

3.56 The ATO, in evidence to the inquiry, supported the OECD's observation commenting that 'many of the problems which already exist in relation to transfer pricing are likely to increase in both number and complexity'.⁵² Arthur Andersen raised concerns for companies, commenting that 'documentation of transactions for transfer pricing purposes will be challenging for companies involved in electronic commerce'.⁵³ Breckenridge, a tax expert with KPMG, commented that 'electronic commerce does change the fundamental problems facing taxpayers and revenue authorities in relation to transfer pricing'.⁵⁴

3.57 The ATO noted, in Finding 16 of *Tax and the Internet*, that increased international trade offers 'increased prospect of transfer pricing, with the speed, frequency, anonymity and integration of exchanges over the internet placing great pressure on the transactional and comparability principles'. The ATO's conclusion was that administration costs will increase as more businesses trade internationally.⁵⁵

51 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 29.

52 Australian Taxation Office, *Submission* p. S468.

53 Arthur Andersen, *Submission* p. S271.

54 Comments made at University of New South Wales, International Tax Symposium: *Transfer Pricing: Implications from Electronic Commerce*, 1997.

55 Australian Taxation Office, *Tax and the Internet*, p. 87.

3.58 In contrast to the previous comments, Bentley suggests that the information capabilities of the internet may help to determine an arm's length price. Bentley states:

Once most businesses are operating on the internet, similar search software to that being developed by AUSTRAC and the United States Treasury Department to track the activities of international crime will be available to the ATO for use in its audit activities. The search capabilities will make it much simpler to find any available information on equivalent products and services. It will also be easier to find information on the factors taken into account in determining an appropriate arm's length price.⁵⁶

3.59 Key issue

Transfer pricing is a complicated part of international intra-company dealings affecting tax liability. The Committee notes the view, held by the OECD and ATO, that internet commerce will lead to further complications with the administration of transfer pricing. The ATO will need to monitor this and ensure that their assessment systems can cope with any increased demand and administrative complexity.

International Approaches

3.60 The United States and European Union have both produced reports on the taxation implications of internet commerce.⁵⁷ The OECD is, through its Committee on Fiscal Affairs (CFA), examining relevant taxation policy concerns.⁵⁸

56 Bentley, D., 'The Internet: Taxing Electronic Transactions', *Taxation in Australia*, Vol. 5, No. 3, February 1997, p. 130.

57 Clinton Administration, *A Framework for Electronic Commerce*, 1 July 1997, [www.iitf.nist.gov/elecomm/ecom.htm]; Commission of European Communities, *A European Initiative in Electronic Commerce*, [www.cordis.lu/esprit/src/ecomcom.htm]; US Dept of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, [www.ustreas.gov/treasury/tax/internet.html].

58 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, pp. 33-35.

3.61 The following discussion provides an outline of the significant issues addressed, and recommendations made by, the United States, the European Union, and the OECD.

United States

3.62 The Clinton Administration has strongly advocated developing the internet as a 'tariff-free zone', and imposing 'no new taxes' on internet transactions.

3.63 These principles were articulated in *A Framework for Global Electronic Commerce* (the *Framework*), released in July 1997, which followed from the US Treasury's 1996 discussion document *Selected Tax Policy Implications of Global Electronic Commerce*.⁵⁹

3.64 The *Framework* identified nine areas where international agreements are needed to encourage internet development. These nine areas can be broken down into financial, legal and market access issues. The key themes of the *Framework* document included the need for governments to refrain from imposing new and unnecessary regulations, encouraging market-driven solutions, and undertaking further public and international consultation.⁶⁰

3.65 Regarding customs and taxation, the *Framework* suggested that many nations are looking for new sources of revenue and may seek to levy tariffs on global electronic commerce. The US rejected this approach and recommended that the internet be declared a tariff free zone.⁶¹ The *Framework* specified that any taxation of internet sales should:

- ...neither distort nor hinder commerce...discriminate among types of commerce...[or] create incentives that will change the nature or location of transactions;

59 Clinton Administration, *A Framework for Electronic Commerce*; US Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*.

60 Clinton Administration, *A Framework for Electronic Commerce*, sections I, II and III.

61 Clinton Administration, *A Framework for Electronic Commerce*, section I.1.

- ...be simple and transparent...capable of capturing the overwhelming majority of appropriate revenues, be easy to implement, and minimise burdensome record keeping and costs for all parties; and
- ...accommodate tax systems used by the United States and our international partners today.⁶²

3.66 The *Framework* also emphasised the need for internet taxation to be consistent, 'across national and subnational jurisdictions', whatever the details.⁶³ In support of that approach, President Clinton publicly endorsed, in February 1998, the proposed Internet Tax Freedom Act, currently being debated by Congress.⁶⁴

3.67 The Internet Tax Freedom Act would prevent any of the estimated 30 000 US tax authorities from introducing any 'discriminatory' internet tax. That is, a tax would be allowed where applied equally to on-line and off-line transactions, but not where applied only to on-line commerce or to the supply of an internet connection. The Act is designed to prevent the development of a fragmented tax regime which would further complicate tax administration of the internet.⁶⁵

European Union

3.68 In April 1997, the European Commission released its *European Initiative in Electronic Commerce* (the *European Initiative*). This paper identified four key elements which would form a development strategy for electronic commerce.

62 Clinton Administration, *A Framework for Electronic Commerce*, section I.1.

63 Clinton Administration, *Text of the President's Message to Internet Users*, Recommendation 1.

64 'White House Resists Taxes on Internet: Clinton to Back Bill Imposing Moratorium', *Washington Post*, 26 February 1998, p. E01; Internet Tax Freedom Act website, 'White House Support' page, [www.house.gov/cox/nettax].

65 Internet Tax Freedom Act website, 'Bill Summary'; Clinton Administration, *Remarks by the President to Technology '98 Conference*, via 'Whitehouse Documents' at [www.whitehouse.gov/WH/html/library.html].

Some of the key issues included data security, intellectual property, privacy and taxation.⁶⁶

3.69 Taxation of internet commerce, both direct and indirect, should, according to the *European Initiative*, include: legal certainty; tax neutrality; and an examination of new tax avoidance and evasion possibilities.⁶⁷ It rejected imposing any new taxes on internet transactions, and, in particular, stated that a 'bit tax', is 'not appropriate since VAT [Value Added Tax] already applies to these transactions'.⁶⁸ The US has also rejected a bit tax.⁶⁹

3.70 The European Union, however, indicated concerns about how a VAT will be applied in an internet commerce environment. In particular, the VAT relies on distinctions between goods and services, and types of services, which are increasingly blurred as a result of digitised information.⁷⁰ For example, it is now difficult to classify traditional 'goods' such as videos which are now available digitally, and messaging services which are both transmission and data processing products.⁷¹

3.71 Another complication for administration of VAT is the zero rate charged for exported products, compared with the positive rate charged for domestically consumed products. The internet complicates this distinction by making it difficult to determine where something is consumed, or produced.⁷²

66 Commission of European Communities, *A European Initiative in Electronic Commerce*, Executive Summary part III.

67 Commission of European Communities, *A European Initiative in Electronic Commerce*, paragraph 56.

68 Commission of European Communities, *A European Initiative in Electronic Commerce*, paragraph 57.

69 Clinton Administration, *Remarks by the President to Technology '98 Conference*.

70 OECD, *Electronic Commerce, The Challenges to Tax Authorities and Taxpayers*, paragraphs 69-77.

71 OECD, *Electronic Commerce, The Challenges to Tax Authorities and Taxpayers*, paragraphs 74, 78.

72 OECD, *Electronic Commerce, The Challenges to Tax Authorities and Taxpayers*, paragraphs 43-46 and 58-68.

3.72 The *European Initiative* commented on the difficulties of applying VAT to internet commerce:

*...thorough analysis is needed to evaluate the possible impact of electronic commerce on present VAT legislation (on issues such as definition, control and enforceability) and to judge if, and to what extent, present legislation needs to be adapted, while ensuring tax neutrality.*⁷³

3.73 In December 1997 the European Union and US government issued a joint statement outlining their electronic commerce policy intentions. This included the stated principle 'That taxes on electronic commerce should be clear, consistent, neutral and non discriminatory'. More specifically, they agreed to 'Close co-operation and mutual assistance to ensure effective tax administration...'.⁷⁴

OECD

3.74 In November 1997, representatives of OECD countries met at Turku, Finland, for a conference entitled 'Dismantling the Barriers to Global Electronic Commerce'.

3.75 A paper introducing an informal round table discussion at the Turku conference, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, outlined the potential for technology-based improvements to tax collection practices.⁷⁵ It also examined three broad categories of potential problems – application of consumption taxes (closely detailing the European Union VAT example), income taxes, and transfer pricing issues.⁷⁶

3.76 The paper highlighted a range of problems with VAT, focusing on the increasing impracticality of 'old' taxation concepts. Some of the concerns included, problems with defining 'goods' and 'services' in the digital era, distinguishing

73 Commission of European Communities, *A European Initiative in Electronic Commerce*, paragraph 57.

74 *Joint EU-US Statement on electronic commerce*, 5 December 1997, [www.qlinks.net/comdocs.eu-us.htm].

75 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, section III.B.a.

76 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, sections III.B,C,D.

between exports and domestic sales in a global market environment, and identifying the jurisdictional location of world-wide intranets.⁷⁷

3.77 The Turku Conference paper raised issues for discussion, but was not intended to recommend policy solutions. On most questions, it concluded that further work was in progress, or needed to be done.⁷⁸ The paper identified eight criteria for assessing potential internet tax options:

- **The system should be equitable.** Taxpayers in similar situations which carry out similar transactions should be taxed in the same way.
- **The system should be simple.** Administrative costs for the tax authorities and compliance costs for taxpayers should be minimised as far as possible.
- **The rules should provide certainty** for the taxpayer so that he or she knows in advance of a transaction what will be the tax consequences. Taxpayers should know what is to be taxed and when and where the tax is to be accounted for.
- **Any system should be effective.** It should produce the right amount of tax at the right time. The potential for evasion and avoidance should be minimised.
- **Economic distortions should be avoided.** Corporate decision-makers should be motivated by commercial rather than tax considerations. This applies to both domestic and international transactions.
- **The systems need to be sufficiently flexible and dynamic** to ensure that the tax rules keep pace with technological and commercial developments.
- **Any tax arrangements** adopted domestically and any changes to existing international taxation

77 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, pp. 17-22.

78 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, pp. 33-35.

principles should be structured to **ensure a fair sharing** of the Internet tax base between countries.

- **Initially the focus should be on adapting existing tax arrangements** to the Internet rather than examining the introduction of new forms of taxation.⁷⁹

3.78 The OECD's Committee on Fiscal Affairs (CFA), which recommended the criteria, acknowledged that many of them would conflict with each other. However, it suggested that the criteria would be generally agreed to.⁸⁰

3.79 The CFA emphasised, in particular, the importance of reaching international consensus for protecting revenue bases while still encouraging development of electronic commerce:

*This consensus could, in practice, be more important than decisions on the actual rules.*⁸¹

3.80 Among the results of the Turku Conference, some of the commitments which were agreed by participating countries, regarding taxation issues include:

- creation of an internet forum where all interested parties could meet for discussions;
- engaging the business sector in a series of working dialogues, particularly on consumption taxes, compliance issues and tax treaties;
- preparation by the CFA of a framework of guidance for the taxation of electronic commerce that could be endorsed by ministers in Ottawa;

79 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, pp. 32-3.

80 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, pp. 33.

81 Committee on Fiscal Affairs, OECD, *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers*, p. 33.

- asking the CFA to look at how tax administrations need to adapt to the new environment; and
- concluded that the criteria of neutrality, fairness, certainty and avoiding excessive taxation would guide work in this area.⁸²

3.81 The Turku Conference will be followed by a ministerial level conference in Ottawa, Canada in October 1998.

Summary of international developments

3.82 The Committee has identified the following general principles common to international governments' internet commerce policies:

- a desire to encourage growth in internet commerce;
- avoidance of policies or new taxes which might foreseeably restrict, hinder or distort internet commerce;
- a light regulatory approach to govern internet commerce;
- neutrality between on-line and off-line commerce;
- international consensus and the development of a uniform and workable taxation framework;
- adaptation of existing taxation administrative systems where possible; and
- any new tax system or strategies to be equitable, simple, predictable, effective, flexible, and fair to all countries.

82 OECD News Release, [www.oecd.org/news_and_events/release/nw97105a.htm].

AUSTRALIAN TAXATION ADMINISTRATION

Introduction

4.1 In 1996, the Australian Taxation Office (ATO) formed a project team to examine the implications of electronic commerce. Some of the participating groups included the Commonwealth Scientific and Industrial Research Organisation (CSIRO), Computer Money Consulting, La Trobe University Online Media Program, Australian Treasury, Australian Customs Service and the Department of Industry, Science and Tourism. As part of this study, the ATO produced the report *Tax and the Internet*, released in August 1997, which contained 29 draft recommendations.¹ The ATO's overarching objective in its report was to achieve neutrality between the physical and electronic worlds. Mr Carmody, Commissioner of Taxation, commented:

In seeking to provide clarity for business, the recommendations are based on the principle of achieving broad neutrality between the treatment of businesses engaged in traditional physical commerce and those engaged in electronic commerce. The project team was also conscious of the need to avoid unnecessary requirements recommending that 'the ATO should be sensitive to the effect of e-commerce regulation'.²

4.2 The ATO, in conducting its review, was well aware of the need to demonstrate sensitivity in developing its findings and recommendations. The ATO noted that internet commerce offered enormous potential for business and

1 Australian Taxation Office, *Tax and the Internet*, AGPS, Canberra, 1997. The report can be downloaded from [www.ato.gov.au/ecp/].

2 Mr Michael Carmody, Australian Tax Commissioner, Statements made at Australian Taxation Office Conference, Sydney, 12 November 1997.

consumer. At the same time, it recognised that it must be sensitive to the effects of electronic commerce regulation on Australia's developing internet commerce industry.³

4.3 Since the release of the report, the ATO has been consulting with business and industry organisations about its findings and recommendations. A subsequent report is expected in June 1998. Some of the ATO's recommendations were criticised during the consultation process. The following sections will review some of the key findings of the report and comment on those recommendations that were the subject of criticism.

Estimates of revenue loss

4.4 The ATO found that in the next one to two years, it is unlikely that 'there will be any appreciable impact on revenue collection'. Beyond this period, however, it was difficult to make predictions.⁴ As part of its examination, the ATO identified key industries which could best adapt to internet commerce. These industries included:

- computer software and hardware;
- travel arrangements;
- books and magazines; and
- music tapes and CD albums.⁵

4.5 These industries were then examined for what they contribute to sales tax and income tax. For 1995-96, it was found that they contributed \$1.8 billion in sales tax and about \$1.0 billion in income tax. With respect to these figures, the ATO stated:

These estimates represent a very crude measure of the impact on the tax base and it is not to say that electronic commerce accounted for a \$2.8 billion erosion of the tax base in 1995-96.⁶

3 Australian Taxation Office, *Tax and the Internet*, Recommendation 4, p. 101.

4 Australian Taxation Office, *Tax and the Internet*, p. 85.

5 Australian Taxation Office, *Tax and the Internet*, p. 31.

6 Australian Taxation Office, *Tax and the Internet*, p. 36.

4.6 The ATO's purpose of this study was to indicate the amount of taxation revenue that was potentially at risk. Furthermore, the ATO pointed out that certain and unlikely criteria would need to be met for the upper bound of these estimates to be reached. The upper bound would apply only if:

- all activities within the selected industries were suitable for electronic commerce;
- all activities within the selected industries were conducted only by electronic commerce; and
- all members of all the selected industries failed to meet any of their taxation obligations.⁷

4.7 The ATO's risk assessment methodology was challenged in evidence to the inquiry. Mr Paul McNab, a senior tax adviser with Coopers & Lybrand, commented that the methodology adopted by the ATO 'in evaluating the likely impact of electronic commerce on the income tax 'tax base' tends to underestimate the potential for damage to Australia's revenue base'.⁸ McNab's main concern was that the ATO's methodology did not acknowledge that rates of growth within the economy are uneven. The ATO responded that it was confident that its upper bound risk assessment was high enough to include 'other types of risks which were not assessed separately' in its report.⁹

4.8 The ATO, in recommendation 6 of its report, proposed that it should continue 'to measure the risks to income tax and the tax system generally from electronic commerce'.¹⁰

7 Australian Taxation Office, *Tax and the Internet*, p. 37.

8 Mr Paul McNab, *Submission*, p. S168.

9 Australian Taxation Office, *Submission*, p. S. 475.

10 Australian Taxation Office, *Tax and the Internet*, Recommendation 6, p. 105.

Goods ordered and delivered electronically

4.9 In December 1997, the Australian Government confirmed that 'goods ordered and delivered electronically will remain customs duty free'.¹¹ It is possible that a wide range of goods and services could be provided electronically. Some examples include software, music CDs, movie videos, magazine articles, news broadcasts, stocks, airline tickets, insurance policies, accountancy services and legal services.¹²

4.10 As more goods and services are able to be converted into electronic form the application of sales tax, or a GST, becomes more complicated. The current wholesale sales tax (WST) applies only to goods. Goods are defined as tangible personal property. The internet makes it possible for products that were previously only available in tangible form, and therefore subject to the WST regime, to be delivered in an intangible form which is not subject to WST. For example, music sold as a CD can now be delivered as a digital signal directly downloaded from the internet onto a home computer. This has the same function as music sold in the traditional physical form but is not subject to WST. The ATO states:

*It is envisaged that the future music and film market may evolve to the point where no 'goods' actually come into existence, with consumers instead buying directly through the internet...this scenario would see a significant erosion of the current WST base as a result of the effective replacement of 'goods' with 'services'...*¹³

4.11 The ATO dealt with some of these issues in findings 28, 29 and recommendation 27 of *Tax and the Internet*. In view of these concerns, the ATO recommended that it 'should

11 *Investing for Growth, The Howard Government's Plan for Australian Industry*, Wordsworth Printing, December 1997, p. 65.

12 More information on digital delivery of goods and services is provided in: US Department of Commerce, *The Emerging Digital Economy*, April 1998, Chapter Four, [www.ecommerce.gov].

13 Australian Taxation Office, *Tax and the Internet*, p. 95.

closely monitor production and marketing strategies adopted by industries likely to be impacted by the replacement of physical goods with on-line services such as music CDs, and movie videos'.¹⁴

4.12 The Committee notes that in GST regimes, operating in other countries, the supply of functionally equivalent 'products' would be expected to attract the same rate of tax, whether in tangible or intangible form. However, where an 'intangible' product is supplied from outside the tax jurisdiction directly to a consumer, the Committee recognises that GST/VAT regimes overseas have experienced practical difficulties taxing these transactions. This is a major issue for these regimes and they are currently searching for enforceable solutions.

Tax advantaged computer programs

4.13 A further issue is the treatment of tax advantaged computer programs (TACPs). Currently, sales tax law excludes from the value of goods that incorporate a computer program, the value of that program, provided that it is not embodied in a microchip. For example, this concession applies to programs carried in disks, tapes and CD ROMs. The ATO warns that as technology advances, more computer programs will be able to take advantage of this sales tax concession, placing the wholesale sales tax base under threat.

4.14 In view of the possibility that more goods will incorporate TACPs, and become entitled to this concession, the ATO recommended that 'the ATO and Treasury should jointly re-examine the issue of exemption from sales tax of tax advantaged computer programs'.¹⁵

4.15 Arthur Andersen (AA) and Telstra were critical of the ATO decision to review the exemption applying to TACPs. AA commented that this review has 'nothing to do with electronic commerce'.¹⁶ Telstra commented that the existing

14 Australian Taxation Office, *Tax and the Internet*, Recommendation 27, p. 128.

15 Australian Taxation Office, *Tax and the Internet*, Recommendation 29, p. 130.

16 Mr Damian Walsh, Arthur Anderson, *Transcript*, 14 November 1997, p. 325.

concession has allowed the growth of software development. Further, Telstra suggested that if the concession was removed, this could inhibit new products and technologies coming on-line.¹⁷

Conclusions

4.16 The Committee is confident that the ATO is correct in its finding that there will not be any appreciable impact on tax collections in the next one to two years. Beyond this point it is difficult to make predictions. At the same time, the ATO's examination of the potential impact of internet commerce on certain industries needs to be put in perspective. While \$2.8 billion was potentially at risk during 1995-96, it is important to remember that the ATO's estimate of internet commerce during 1996 was only \$10 million and www.consult's estimate for 1997 was \$37.5 million.

4.17 As internet commerce expands, however, more taxation revenue could be put at risk and therefore monitoring of the impact of internet commerce on the taxation base is required. The Committee notes the concerns raised by McNab that the ATO could have underestimated the potential revenue loss. This observation draws attention to the assumptions and reliability of the ATO's methodology for estimating revenue loss. It is essential that the ATO continue to enhance its methodologies and ensure that it is keeping up with developments in internet commerce.

4.18 The Committee, therefore, supports the ATO with its objective to continue measuring the risks to income tax and the tax system generally from internet commerce. In addition to this objective, the ATO should report its findings on a regular basis in its annual report. In this way the Parliament and community will be kept informed of developments in this important area.

4.19 Concessions applied to tax advantaged computer programs (TACPs) could be extended to more goods as technology advances. The Committee encourages the ATO and Treasury to review the range of goods which incorporate

TACPs. The Government must have accurate information on potential sales tax revenue loss if it is to make informed decisions regarding concessions applying to TACPs.

4.20 Key issue

The Committee notes the potential for consumers to order and receive goods, such as music CDs and movie videos, over the internet. The Committee supports the Government's policy that these 'goods' be customs duty free. The Committee also supports the ATO in monitoring developments in this area.

4.21 Technically, sales tax does not apply to products delivered electronically. The Committee notes that in a GST environment, supply of functionally equivalent 'products' should attract the same rate of tax, whether in tangible or intangible form. However, the supply of intangible products from outside the tax jurisdiction is a major issue for overseas GST/VAT regimes. These regimes are currently searching for solutions and it is clear that international cooperation and agreement will be necessary to achieve solutions to identifying and taxing electronic commerce.

4.22 Many of the issues associated with monitoring and taxing internet commerce, which are the subject of the ATO's report, would also be of relevance in a GST context. The Committee is seeking more information from Treasury and the ATO on international developments concerning possible strategies for collecting GST on products and services that are ordered and delivered electronically. For example, in the future it is possible that millions of Australians could be downloading music on to blank CDs in their own homes and the ATO could have significant problems with GST compliance.

4.23 Recommendation 2

The Australian Taxation Office must continue to monitor the risks to income tax and the tax system generally from internet commerce, continue to enhance methodologies for determining revenue loss, and report its findings on a regular basis in its annual report.

17 Mr Darren Adam, Telstra, *Transcript*, 15 December 1997, p. 392.

4.24 Recommendation 3

Treasury and the Australian Taxation Office should report on international developments concerning possible strategies for collecting GST on products and services that are ordered and delivered electronically.

Neutrality

4.25 In addressing internet commerce, the ATO's core principle is 'neutrality' between on-line and off-line commerce. The neutrality principle ensures that no distortions will be introduced into the market which could affect the development of internet commerce.

4.26 The US Treasury stated its support for neutrality in its November 1996 policy paper. Later, the importance of neutrality was emphasised by President Clinton who commented that approaches to taxing electronic commerce should be based on existing taxation concepts and principles.¹⁸ In addition, the Internet Tax Freedom Act, now before the US congress, seeks to provide neutral tax treatment of economic activity.¹⁹ President Clinton stated that 'legislation does not prevent state and local governments from applying existing taxes to electronic commerce, as long as there is no discrimination between an internet transaction and a traditional one'.²⁰

18 US Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, November 1996, p. 19, [www.ustreas.gov/treasury/tax/internet/html]; Clinton Administration, *A Framework for Electronic Commerce*, July 1997, section I.1, [www.whitehouse.gov/WH/New/Commerce/].

19 See [www.house.gov/cox/Nettax/taxfreedom.htm].

20 President Clinton, *Remarks by the President to Technology 98 Conference*, 26 February 1998, via 'Whitehouse Documents' search, [www.whitehouse.gov/WH/html/library.html].

4.27 The ATO provided the following definition of neutrality:

...neutrality essentially means that the same principles should apply to internet businesses as are applicable to traditional business operations. This applies not only to the determination of taxing rules, but also to compliance requirements.²¹

4.28 There is general support, in evidence to the inquiry, for the concept of 'neutrality' but there is not agreement as to how existing laws will be adapted to ensure that they are appropriate for internet commerce. The Australian Society of CPAs (ASCPA) suggests that 'neutrality' means no changes to tax law and argues that 'there is no need to write new or amend existing legislation to accommodate electronic commerce'.²²

4.29 ASCPA's strict interpretation that neutrality means no change to existing laws is not supported by some groups. The Sacher Report commented that most of the existing legal and regulatory mechanisms applying to commercial activity were developed before the era of advanced electronic communications.²³ The Sacher Report stated:

Where appropriate, governments should adjust existing laws and regulations so that they apply to 'intangible' as well as 'material' product environments. They should ensure that all future actions regarding consumer protection laws and regulations are closely co-ordinated with developments in Electronic Commerce.²⁴

4.30 The Report of the Electronic Commerce Expert Group to the Attorney-General (the Expert Group) expressed its support for neutrality. This report stated that a key principle in addressing electronic commerce is 'achieving functional equivalence which means that, as far as possible,

21 Australian Taxation Office, *Submission*, p. S462.

22 Australian Society of CPAs Comments on ATO Discussion Paper of the Electronic Commerce Project on Tax and the Internet, Attachment to Submission No. 44, *Exhibit No. 29*.

23 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, OECD, Paris, 1997, p. 67.

24 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 16, [www.oecd.org/dsti/sti/it/ec/act/sacher.htm].

paper based commerce and electronic commerce should be treated equally by the law.²⁵ The Expert Group, however, suggested that some legislative change was needed. The Expert Group stated:

Most of the legal and regulatory mechanisms currently being applied by governments to commercial activity were conceived in an era before the advent of advanced electronic communications systems. They are generally state-based or national in orientation and, in terms of frameworks of commercial policy, law and regulation are oriented to trade in tangible goods. In contrast, electronic commerce has the propensity to ignore sectoral, regional and national boundaries, while tending to accentuate the intangible aspects of commerce, that is the process of commerce, rather than the tangible.²⁶

4.31 The Expert Group recommended a set of minimum legislative requirements that 'create a scheme of national application that reduces uncertainty about the use of electronic commerce and removes existing legal obstacles to its use.'²⁷

4.32 The US Treasury also discussed the introduction of proposed regulation on computer program transactions.²⁸ The ATO suggested a number of areas where regulatory change could be appropriate. The significant changes are covered under recommendations 10 to 14 in *Tax and the Internet*. The ATO also surveyed various legislation relevant to evidence collection that could be affected. It made the following comments:

- **Commonwealth Evidence Act** — Section 69 provides for exceptions to the Hearsay rule in the case of business records, whilst Section 71 excepts telecommunications by way of electronic mail, fax, telegram, lettergram or telex. The ATO claims that there is a problem with Section 71 because it may

25 Report of the Electronic Commerce Expert Group to the Attorney-General, *Electronic Commerce: Building the Legal Framework*, Canberra, March 1998, p. i.

26 *Electronic Commerce: Building the Legal Framework*, p. 148.

27 *Electronic Commerce: Building the Legal Framework*, p. i.

28 US Department of the Treasury, *Selected Tax Policy Implications of Global Electronic Commerce*, section 0.3.3.

be too specific to include internet documents such as Hypertext Markup Language forms and other digital telecommunications transactions and types of evidence under its ambit.

- **Corporations Law** — Section 219 specifies that on every document or negotiable instrument of a company the company must display its ACN number. The ATO indicates that it is not clear whether this provision applies to the provision of ACN numbers on business websites.
- **Telecommunications Act** — A general obligation on all parties is to assist authorities of the Commonwealth and of the States and Territories for the purposes of enforcing the criminal law. Section 47 specifies protecting the public revenue and safeguarding national security. Under Sections 83 and 84, carriers are also required to keep detailed records and books that enable the separate identification of charges and services.²⁹
- **Income Tax Assessment Act** — The operation of Section 262A (general record keeping) should be analysed to ensure its effectiveness in relation to internet businesses.³⁰

The National Office for the Information Economy

4.33 Internet commerce impacts on the responsibilities of a wide range of government agencies and legislative review is not just restricted to taxation matters. The National Office for the Information Economy (NOIE) was established to provide a whole of government approach to the information economy.

4.34 NOIE is a separate entity within the Communications, Information Economy and Arts portfolio and reports to the Minister for Communications, the Information Economy and the Arts, Senator Richard Alston. NOIE is

29 Australian Taxation Office, *Tax and the Internet*, pp. 76–77.

30 Australian Taxation Office, *Tax and the Internet*, p. 61.

assisted by an advisory board which draws on private sector expertise. NOIE's role is to develop, coordinate and overview broad policy relating to:

- the regulatory, legal and physical infrastructure environment for online services, including facilitating electronic commerce;
- ensuring consistency of Commonwealth positions for international fora; and
- overseeing policies for applying new technology to government administration and information and service provision.

4.35 NOIE also works closely with a ministerial council chaired by Senator Alston and including the Minister for Trade; the Minister for Industry, Science and Tourism; the Minister for Employment, Education, Training and Youth Affairs; the Minister for Finance and Administration; the Treasurer; and the Attorney-General.

Conclusions

4.36 The Committee supports the concept of neutrality. It is essential that internet commerce should flourish and this can best be achieved by a regulatory regime that does not create an imbalance between physical and internet commerce. At the same time, the existing regulatory regime was developed in an era where internet commerce had not evolved. In view of this it may be appropriate to adjust legislation to ensure that internet commerce is adequately covered. Therefore, the Committee rejects the view held by some groups that neutrality means no change to existing law.

4.37 The ATO, and other government agencies, in applying neutrality principles must ensure the use of best practice processes and requirements for developing and amending legislation and regulation. The Office of Regulation Review (ORR) has produced *A Guide to Regulation* with advice on this matter. The ORR discusses the need for and use of Regulation Impact Statements (RISs).³¹

31 Office of Regulation Review, *A Guide to Regulation*, AGPS, Canberra, First Edition, 1997.

4.38 The Committee notes that the range of legislation relating to internet commerce covers much more than just the responsibilities of the ATO. Other areas relating to internet commerce which may require legislative and regulatory review include evidence collection, documentation, administration of criminal law, consumer protection, and privacy. It is clear then that a whole of government approach to reviewing legislation is required. The responsibility for this should lie with the National Office for the Information Economy (NOIE). The Committee supports the role and objectives of NOIE. It is essential that the often disparate work of government be brought together by a central agency.

4.39 With respect to legislative review, the Committee suggests that it is essential that NOIE coordinate this activity. It is best equipped to ensure that relevant government agencies, industry and the community sector are consulted. If and when the government develops amending legislation relating to internet commerce, it is recommended that the government refer these bills to the Committee for an advisory report. The nature and complexity of the legislation may preclude detailed examination by either chamber. In addition, further community input to the legislation could be achieved through this process.

4.40 Recommendation 4

The Parliament should refer future Bills relating to internet commerce to the Joint Committee of Public Accounts and Audit for an advisory report to the Parliament.

ATO Report - *Tax and the Internet*

4.41 The ATO in its report, *Tax and the Internet*, made 29 recommendations. Many of these recommendations are non-regulatory and are seeking to improve co-operation with other revenue collection agencies, designed to enhance market knowledge, and continue research in selected areas. Recommendations 10 to 14 focused on identification and authentication and could require regulatory change. It is these recommendations that received the most attention in the ATO's consultation process, and during the Committee's inquiry.

4.42 The following discussion examines the ATO's original recommendations 10 to 14, reviews the evidence that was received by the Committee, and comments on the ATO's revisions.

4.43 The ATO's original recommendations 10 to 14, shown in *Tax and the Internet*, are reproduced below:

- **Recommendation 10:** The ATO should liaise with the Australian Securities Commission to ensure that site identifiers such as company and businesses names and ACN or uniform company numbers are mandatory on commercial websites. International agreement should be sought for this recommendation.
- **Recommendation 11:** Webshops should be registered.
- **Recommendation 12:** Organisations that operate or host Webshops should be registered.
- **Recommendation 13:** A legislative and technical framework required to monitor commercial internet traffic should be determined in consultation with the Attorney-General's Department, the Department of Communications and the Arts, AUSTRAC and others.
- **Recommendation 14:** A record of the ranges of IP internet numbers of Australian based computers should be maintained.

4.44 After the ATO's consultation process and Committee's examination, the ATO revised recommendations 11 and 13 and withdrew recommendation 12.

ATO Recommendation 10

4.45 The ATO's recommendation 10 received general support. Most groups believed that the requirement to include company identifiers on business websites was not onerous. In addition, it was suggested that the inclusion of this information would help to improve business credibility and raise consumer confidence. The Department of Communications and the Arts (DoCA) stated:

We understand that the legal position on the requirement to display ACN numbers on websites is not entirely clear, but many companies already do display this information. As ACN numbers are already public information, a requirement that they be displayed on public websites does not seem unreasonable, and indeed it may be in a company's interests to do so, as it could give assurance to customers that they are dealing with a bona fide organisation.³²

4.46 The advantages of including business identifiers on business websites was supported by the Jewellers Association of Australia and the Commonwealth Law Enforcement Board (CLEB).³³ CLEB suggested that the requirement for businesses to adequately identify themselves on their websites is consistent with commercial objectives because it will help to instil consumer confidence and achieve mass market penetration.³⁴

4.47 The Internet Industry Association (IIA) supports recommendation 10 and indicated that it is including the need for company identifiers in its internet industry code of conduct. IIA claims that 'the use of Australian Company Numbers (ACN), registered business names and a free market use of a certification system with authority behind it will make people as identifiable over the internet as they are in ordinary commerce'.³⁵ IIA commented that the inclusion of this information was not 'particularly onerous'.³⁶

4.48 Some reservations about recommendation 10 were made by the Australian Society of Certified Practising Accountants (ASCPA). ASCPA supports the use of site identifiers such as company and business names and ACN numbers on commercial websites but suggests it is inappropriate for the ATO to carry out this task, and proposes

32 Department of Communications and the Arts, *Submission*, p. S584.

33 Jewellers Association of Australia, *Submission*, p. S57.

34 Ms Elizabeth Montano, Commonwealth Law Enforcement Board *Transcript*, 16 December 1998, pp. 496-497.

35 Mr Patrick Fair, Internet Industry Association, *Transcript*, 5 November 1997, p. 187.

36 Mr Michael Ward, Internet Industry Association, *Transcript*, 3 February 1998, p. 550.

that this be the responsibility of the Australian Securities Commission.³⁷

4.49 The ATO advised that recommendation 10 has attracted general support.³⁸ In addition, the ATO commented that it is currently working with the Australian Securities Commission on the issues raised in recommendation 10 to ensure that ACN numbers are displayed on appropriate websites.³⁹

ATO Recommendations 11 and 12

4.50 Recommendations 11 and 12 were strongly criticised. These recommendations propose that webshops and the organisations that operate or host webshops should be registered. Telstra claimed that these recommendations would impose 'unreasonable compliance costs on industry participants and will inhibit the growth of internet commerce and thus reduce the amount of revenue on which tax can be levied'.⁴⁰ In addition, Telstra argued that it was difficult to see how the information that the ATO propose to collect 'would assist them in assessing the liability of a particular taxpayer or in providing statistical information which may assist them in identifying taxpayers who should be the subject of audit activity'.⁴¹

4.51 Telstra claimed that recommendation 12 would impose an unreasonable burden on web hosting organisations.⁴² In summing up its concerns with the ATO's recommendations, Telstra stated:

The introduction of a web of onerous tax compliance obligations to address an expectation of large scale erosion of the Australian tax base is likely to have a number of adverse

37 Exhibit No. 29, Australian Society of CPAs Comments on ATO Discussion Paper of the Electronic Commerce Project on Tax and the Internet, Attachment to Submission No. 44.

38 Mr Frank Merrick, Australian Taxation Office, *Transcript*, 3 February 1998, p. 548.

39 Australian Taxation Office, *Submission*, p. S470.

40 Telstra, *Submission*, p. S46.

41 Telstra, *Submission*, pp. S46-47.

42 Telstra, *Submission*, p. S47.

*consequences for Australian business. One of the effects of such new obligations will be significant compliance costs which will force many small businesses out of the emerging electronic commerce market. Australia will become an unattractive place for new investment in electronic commerce, and medium to large Australian businesses will be incited to move their electronic commerce operations outside Australia.*⁴³

4.52 The Industry Commission (IC) examined the ATO's recommendations 11 to 14 and commented that they 'would imply significant regulatory imposition on Internet Service Provider (ISP) facilities in order to conduct widespread and potentially intrusive surveillance of internet transactions'. The IC advised that these recommendations should not proceed until a regulatory cost-benefit analysis, including preparation of a Regulation Impact Statement, had been undertaken.⁴⁴

4.53 Some groups suggested that recommendations 11 and 12 were inconsistent with the neutrality principle. IIA commented that they apply 'a more onerous burden to the internet than we apply to the operation of other commercial practices'.⁴⁵ DoCA stated:

*In relation to licensing of Webshops, and of organisations that operate Webshops, we consider that it is important that the principle of neutrality is observed - ie business engaging in electronic commerce should be subject to broadly equivalent arrangements to those engaged in 'real world' physical commerce. License requirements should not be imposed on Web commerce if they are not currently required for traditional physical commerce.*⁴⁶

4.54 Mr Marzbani, of www.consult, grouped recommendations 11 to 14 together and commented that they

43 Telstra, *Submission*, p. S49.

44 Industry Commission, *Submission*, p. S376.

45 Mr Michael Ward, Internet Industry Association, *Transcript*, 3 February 1998, p. 550.

46 Department of Communications and the Arts, *Submission*, p. S584.

are 'unlikely to have any impact on tax compliance whatsoever by anyone out there, whether in Australia or overseas'.⁴⁷

4.55 At the Committee's round table forum on 3 February 1998, the ATO indicated that it would review recommendations that had attracted the most comment. The ATO commented:

*Recommendations 11 to 14 fall into a group of recommendations that have attracted some critical comment. To address this we have commissioned the CSIRO, who were responsible originally for these recommendations, to re-examine them, to see whether in fact they are justified or whether some alternatives are viable and so on. That will be done over the next couple of months.*⁴⁸

4.56 Since the round table forum, the ATO has revised recommendations 11 to 14.

4.57 The ATO's new recommendation 11 reads:

- **New Recommendation 11:** Registration requirements for commercial websites should be broadly equivalent to requirements for entities in 'real world' commerce.

4.58 The ATO has amended Recommendation 11 to take into account various criticisms while maintaining the neutrality principle. The ATO maintains that the same requirement should apply in the electronic world to connect the identity of the taxpayer to the economic activity. The form of registration should seek to minimise cost of compliance, but it would seem that linking of website details to existing registration requirements would be an appropriate starting point.

4.59 The ATO withdrew Recommendation 12 commenting that 'satisfactory arrangements can be made for accessing data held by ISPs, either cooperatively or through existing enforcement provisions, without requiring special registration procedures for internet service providers.'

47 Mr Ramin Marzbani, *www.consult, Transcript*, 3 February 1998, p. 548.

48 Mr Frank Merrick, Australian Taxation Office, *Transcript*, 3 February 1998, p. 548.

ATO Recommendations 13 and 14

4.60 DoCA commented that recommendations 13 and 14 were the 'most controversial in the report from the perspective of the internet industry'.⁴⁹ With respect to recommendation 13, DoCA identified several 'serious implications':

- while it is technically possible to monitor and log IP packets, with current technology monitoring is likely to significantly slow the flow of IP traffic through routers and servers, to the point where the service becomes dysfunctional;
- the amount of information gathered could potentially be vast (many billions of IP packets) and extremely difficult to process meaningfully;
- monitoring could fall substantially on ISPs, representing a significant cost burden on them; further it may not be appropriate to ask ISP to police the activity of their customers on behalf of the ATO or anyone else;
- there are significant implications for privacy and security in monitoring; and
- even if messages were intercepted, modern cryptographic technologies could render it impossible to decipher, without access to the keys.⁵⁰

4.61 Telstra suggested that the proposal to monitor internet traffic could be in breach of the *Telecommunications (Interception) Act 1979* which 'expressly prohibits the interception of a communication passing over a telecommunications system'.⁵¹ The IC stated that 'at current relatively modest levels of internet commerce, the costs of monitoring and enforcing taxation of these transactions could easily outweigh the benefits'.⁵²

49 Department of Communications and the Arts, *Submission*, p. S584.

50 Department of Communications and the Arts, *Submission*, p. S585.

51 Telstra, *Submission*, p. S47.

52 Industry Commission, *Submission*, p. S376.

4.62 The ATO suggested that 'monitoring' in recommendation 13 was possibly misinterpreted. Monitoring meant monitoring of internet packet traffic. The header of an internet packet, even in encrypted transmissions, could identify certain payment protocols such as SET, Mondex, Cybercash and Digicash.⁵³ The ATO claimed that 'statistical information gathered from traffic across the network is capable of supporting the identification of some unreported commercial activity'.⁵⁴ The ATO also suggested that the neutrality principle is maintained because it already has the ability to monitor offline financial data held by businesses, banks and credit card companies.

4.63 With respect to recommendation 14, DoCA questions the practicality of obtaining IP numbers available to Australians. The reason for this recommendation is the ATO's concern that there is no definitive list of IP numbers of those computers that are located in Australia. Therefore, it is not possible to determine whether a particular IP number is located in Australia. If this information was known it would be possible, for example, to use it to determine jurisdiction for taxing purposes.

4.64 Telstra and the IIA suggested that IP numbers may not be a useful source of information because they are often assigned temporarily. The IIA stated:

...the allocation of IP addresses for computers being maintained seems to me to be a point of little or no significance for the management of business or the maintenance of any record of the transactions of business through the internet in this country. Given...that IP numbers are dynamically allocated to all but those with permanent connections, that seems a mechanism for creating a log of irrelevance.⁵⁵

53 Australian Taxation Office, *Tax and the Internet*, p. 112; Electronic Commerce Task Force, *Report of the Electronic Commerce Task Force to the Commonwealth Law Enforcement Board*, November 1996, p. 97.

54 Australian Taxation Office, *Tax and the Internet*, p. 112.

55 Mr Michael Ward, Internet Industry Association, *Transcript*, 3 February 1998, p. 550.

4.65 The ATO's new recommendation 13 reads:

- **New Recommendation 13:** Existing ATO and Telecommunications legislation provides the ATO with appropriate authority to access the audit files of Webshops. The ATO and the Internet industry should agree on the type and format of logs that should be maintained by Webshops, and for how long they should be held.

4.66 The ATO has significantly revised recommendation 13 and again applied the neutrality principle in guiding its revision. In the physical world, the ATO has the power to audit the financial records of individuals and businesses. The ATO is seeking the same power in the electronic world. Therefore, commercial websites would be required to keep logs of internet commercial transactions in a form, and for a period, to be decided by consultations between the industry and the ATO. As the need arises the ATO, on a case by case basis, could audit these financial logs in much the same way it can audit 'physical' financial records.

4.67 The ATO's Recommendation 14 is unchanged. The ATO consulted with the CSIRO on the application of this recommendation. The ATO points out that the registration requirements in Recommendations 14 and 11 must work in tandem to ensure that a list of IP numbers are accurate and up to date.

4.68 As discussed above, IP numbers may assist in defining the jurisdiction in which the webshop is operating. Through this information, the ATO claims that 'commercial website registration and a 'census' of IP numbers will considerably reduce the costs, and improve the efficiency, of necessary regulatory activity in areas such as tax, company law, criminal law and consumer protection'.

Conclusions

4.69 The ATO's research on internet commerce and taxation administration has helped to improve the knowledge base in this field, domestically and internationally. The findings and recommendations in *Tax and the Internet* have provided the focus for a wide ranging and constructive debate which most groups would agree has been achieved. In releasing *Tax and the Internet*, the ATO stated in the report, and at various public hearings, that the report does not represent a final position.

4.70 Many of the findings and recommendations in *Tax and the Internet* were general in effect and have no regulatory implications. For example, the ATO should plan for international co-operation, be sensitive to the effect of electronic commerce regulation on the emerging internet commerce industry, and that it should become an internet citizen. Recommendations 10 to 14, however, were identified as having regulatory implications.

4.71 Recommendation 10 is seeking the inclusion on commercial websites of company and business names and Australian Company Numbers or uniform company numbers. There was general support, in evidence to the inquiry, for this recommendation. The Committee is aware of the need to raise consumer confidence in electronic payment systems and internet commerce generally. The provision of business identifiers on commercial websites will help to raise consumer confidence. Businesses will also stand to gain if levels of commerce increase. At the same time, the provision of business identifiers should not be onerous. Therefore, the Committee supports the ATO's Recommendation 10.

4.72 Recommendations 11 and 12 were the subject of criticism from various groups. These recommendations propose that webshops and the organisations that operate or host webshops should be registered. There was a large body of evidence suggesting that these recommendations would be onerous and impose an unreasonable burden on web hosting organisations. At the same time, many groups considered that the costs would outweigh any benefits.

4.73 The ATO has subsequently amended Recommendation 11 and withdrawn Recommendation 12. The Committee supports the application of the neutrality principle. That is, just as a business operating in the 'physical world' must meet certain registration requirements,

enterprises conducting business through electronic sites should also be registered. The Committee, however, has not been advised as to whether this outcome can be achieved under existing legislation. If not, then legislative amendment would be necessary. In this event, the Committee would seek to review this legislation when it comes before the Parliament. That way, further comment from the business community could be received regarding compliance and the effectiveness of this measure.

4.74 Similarly, Recommendations 13 and 14 were highly controversial and were criticised for being intrusive, having implications for privacy, and offering no real benefits. The Committee is pleased that the ATO has amended Recommendation 13. The ATO is seeking to have the same rights, as it does in the 'physical world', to access the audit files of webshops on a case by case basis.

4.75 The original Recommendation 13 was interpreted by some groups that the ATO would monitor internet traffic randomly and on an ongoing basis. The ATO will not be conducting this type of surveillance. The ATO has indicated that it will consult the Internet industry on the type and format of logs to be kept by webshops for audit. The Committee would be pleased if this outcome could be achieved under existing legislation and with the support of the internet industry. Again, if legislative amendment is required, then the Committee would seek to review this legislation.

4.76 Key issue

The proposal to record the range of IP numbers has been criticised from a point of practicality. If these problems, however, could be overcome then having this information could assist with taxation and law enforcement. The ATO should canvass at international fora its proposal for IP numbers and determine the extent of international support for this measure.

4.77 Overall, the Committee will monitor developments with Recommendations 11, 13 and 14. While the ATO has presented a persuasive case for these recommendations, there is still time for it to monitor developments in other countries. Australia does not need to be the first in the world in introducing measures of which the full impact is not properly understood.

4.78 Recommendation 5

Any legislative amendments arising from recommendations of the Australian Taxation Office be referred to the Joint Committee of Public Accounts and Audit for an advisory report.

State taxation issues

4.79 Some groups, in evidence to the inquiry, suggested that Financial Institutions Duty (FID) and Debits tax could disadvantage Australia's performance in internet commerce. Debits tax and FID are State and Territory government imposed taxes on financial transactions.

4.80 FID is a tax on receipts of financial institutions applied in all States and Territories, except Queensland. It was first introduced in December 1982 and raised about \$1.1 billion in 1996-97. Debits tax is applied to debit transactions from accounts with cheque access. It was first introduced by the Commonwealth Government in 1982 as Bank Account Debits (BAD) tax. In 1991, Debits tax was transferred to the States and raised \$875 million in 1996-97.⁵⁶

4.81 The Australian Bankers' Association (ABA) claims that Australia is the only developed nation that imposes taxes on financial transactions. The International Banks and Securities Association of Australia (IBSA) makes a similar observation:

*A point that is significant is that similar taxes just do not exist anywhere else in the world. I think there is one country that is an exception to that. Basically, financial institutions duty or a transactions tax of that nature do not exist. Therefore, at the first stage there is a cultural issue to be addressed for financial institutions looking at operating here.*⁵⁷

4.82 Evidence to the inquiry suggested that financial transaction taxes will place Australia in an uncompetitive international situation as global electronic commerce evolves.

56 Australian Bankers' Association, *Submission*, p. S120.

57 Dr David Lynch, The International Banks and Securities Association of Australia, *Transcript*, 6 November 1997, p. 243.

The onset of internet banking will provide business with more choice and therefore the opportunity to avoid transaction taxes such as FID and Debits tax. IBSA comments that 'in an era when international competition in finance has greatly intensified, and is continuing to do so, FID acts like lead weights on the legs of the industry as it strides forward into the future'.⁵⁸ The ABA states:

*In a global market it becomes relatively simple to avoid such taxes. If both parties to the transaction maintain Australian dollar accounts offshore, then it simply involves the transfer of funds from one offshore financial institution to another. If accounts are held offshore in another country, then this currency can be exchanged in settlement of the transaction...such instructions can be communicated to the offshore financial institutions via the internet at very low cost. The incentives are very clear and it is questionable whether such a transaction would be liable for FID or not.*⁵⁹

4.83 IBSA also claims that FID will not continue to be a viable tax for State and Territory Governments. In part, this is demonstrated by the fact that State and Territory leaders sought to replace FID and Debits Tax with a broad based Debits Tax.⁶⁰ In view of these concerns, IBSA, ABA and the National Australia Bank (NAB) propose that FID and Debits tax be abolished. The NAB stated:

*The National also notes that FID and Debits Tax are unique to Australia. Australia's ability to become either a global or regional financial centre will be severely restricted as investors attempt to grapple with an unknown transaction cost. Regardless of the probability of fundamental taxation reform, the Commonwealth, State and Territory Governments should immediately co-operate to abolish both taxes.*⁶¹

58 The International Banks and Securities Association of Australia, *Submission*, p. S330.

59 Australian Bankers' Association, *Submission*, p. S122.

60 Australian Bankers' Association, *Submission*, p. S122; The International Banks and Securities Association of Australia, *Submission*, p. S329.

61 National Australia Bank, *Submission*, p. S493.

Conclusions

4.84 Australia must ensure that it is internationally competitive in all areas of internet commerce. The Commonwealth and State Governments will need to ensure that they cooperate in achieving this national goal. The discussion of FID and Debits tax provides an example of where future work is required between the different levels of government.

4.85 The Committee notes that, from the perspective of internet commerce, there are persuasive reasons for abolishing FID and Debits tax. Australia is the only country to apply these taxes, and, as internet commerce expands, Australia could be disadvantaged by continuing with them.

4.86 Recommendation 6

That State Governments, in consultation with the Australian Government, abolish Financial Institutions Duty and Debits Tax.

International taxation cooperation and agreement

4.87 One of the key observations made about taxation and internet commerce is the need for international taxation cooperation and agreement on taxation. A range of groups, in evidence to the inquiry, warned of the consequences of tax administrations taking unilateral action. The ATO has, on several occasions, expressed the importance of international action. Finding 21 of *Tax and the Internet* stated that 'broad based international co-operation will be required to administer domestic tax laws in relation to electronic commerce'. In particular, the ATO stated:

While some revenue loss can be addressed by changes to the existing income tax law, in most cases the key concepts are so inappropriate that they will be unable to maintain the current level of revenue. International agreement on the allocation of taxing rights will be required. It will also be

*necessary to regulate the operation of the internet if current and future tax laws are to be enforceable, and such enforcement will only be possible through concerted international co-operation.*⁶²

4.88 The ATO built on Finding 21 with recommendations 2 and 3 which proposed that the ATO should plan for international co-operation, and continue its role in having taxation and internet issues debated at international fora. The ATO has co-authored a major OECD paper on internet commerce and taxation issues, and chaired an OECD electronic commerce specialist group on tax evasion and avoidance.

4.89 In November 1997, Australia's Commissioner of Taxation, Mr Michael Carmody, chaired a Round Table Discussion in Turku, Finland between government and business representatives on taxation aspects of electronic commerce. This conference will be followed by a ministerial level conference in Ottawa, Canada in October 1998. The ATO reports that 'Ministers will be asked to endorse broad guidelines and protocols to govern all aspects of electronic commerce, including taxation.'⁶³

Conclusions

4.90 The Committee commends the work and leadership of the Australian Taxation Office (ATO) in examining the implications of internet commerce for taxation administration. The ATO has helped to promote discussion of these issues at international fora.

4.91 Key issue

The Australian Government should continue to support the ATO in progressing uniform international approaches to taxation sharing arrangements, internet operations and intra company profit shifting.

62 Australian Taxation Office, *Tax and the Internet*, p. 89.

63 Australian Taxation Office, *Submission*, p. S463.

4.92 The ATO should maintain its focus on solutions through international cooperation and agreement. Rather than pioneering the development of domestic legislation ahead of other nations, the ATO should closely monitor domestic internet operations including the use of tax avoidance packages and programs.

5

THE CUSTOMS SCREEN FREE LIMIT

Introduction

5.1 The Customs 'screen free limit' is a general term used to describe the duty and sales tax free limit and the commercial entry thresholds for imported goods. If the duty and sales tax on an imported good is less than \$50 and the value of the consignment is below the commercial entry threshold then no customs duty is required and the consignment is screened free. Some Australian retailing groups suggest that internet commerce will lead to greater use by consumers of this customs treatment. As a result, it was claimed that some Australian businesses could lose market share and their future viability could be threatened.

5.2 The Australian Customs Service (Customs) does not record data on those imports that are screened free. In response to the Committee's inquiry, Customs commissioned a survey of low value goods. The Committee will compare these results against the claims made by some retailing groups. This analysis is fundamental to determining the appropriateness of the duty and sales tax free limit, currently set at \$50, and the commercial entry thresholds.

5.3 The commercial entry thresholds are currently set at \$1000 for goods imported by post and \$250 for goods imported otherwise than by post. The Government has indicated that it is deferring making changes to the commercial entry thresholds until the Committee has reported. On 4 March 1998, the Minister for Customs and Consumer Affairs, the Hon Warren Truss, MP, stated:

The Joint Committee of Public Accounts and Audit is presently conducting an inquiry into internet commerce. In light of the reporting time frame of the JCPAA, it is the government's view that we should not proceed with any

proposed changes to existing entry thresholds until the government has had sufficient time to consider the committee's findings on this issue.¹

The screen free limit

Definition and purpose

5.4 Section 68 of the *Customs Act 1901* sets out the commercial entry thresholds. This section requires that there be a formal entry declaration for all goods imported into Australia. The exceptions to this rule include goods imported by post not exceeding a value of \$1000, and goods imported otherwise than by post not exceeding a value of \$250 (Sections 68(1) (e) and (f)).

5.5 Item 32B of Schedule 4 of the *Customs Tariff Act 1995* provides for the waiver of duty where 'in the opinion of the Chief Executive Officer, the amount of duty that, but for this item, would be payable and the value are insubstantial'. Similarly, Item 187 of Schedule 1 of the *Sales Tax (Exemptions and Classifications) Act* provides for the waiver of sales tax.

5.6 Customs By-Law No. 9640087 gives effect to Item 32B by asserting that no import duties are required on a 'consignment of goods imported by post, the total value of which does not exceed \$1000 and on which the combined duty and sales tax, if any, that would otherwise be payable does not exceed \$50'. The same situation applies to goods imported otherwise than by post up to a total value of \$250. The duty and sales tax free level has been set at \$50 since 1991. Between 1985 and 1991 the level was set at \$20.²

5.7 The following examples show how the duty and sales tax free limit and commercial entry thresholds work. If a consignment of toys worth \$100 is imported into Australia then no formal entry declaration is required because the value

1 Parliamentary Debates (Hansard), House of Representatives, Customs and Excise Legislation Amendment Bill (No. 3) 1997, Consideration in Detail, 4 March 1998, p. 483.

2 Australian Customs Service, *Submission*, p. S143.

is below the \$1000 and \$250 thresholds. In addition, the duty and sales tax payable is \$32.72, so the \$50 free level is not exceeded. Therefore, the goods are 'screened free'.

5.8 If a parcel of toys worth \$200 is imported into Australia, again no formal entry declaration is required because the value is below the \$1000 and \$250 thresholds. However, the sales tax amounts to \$65.44, which means the \$50 free level is exceeded. Therefore, the goods are not 'screen free' and the \$65.44 is payable by an informal clearance document (ICD).

5.9 If an imported postal consignment was valued at \$1100 then a formal entry declaration would be required. The duty and sales tax, even if it was less than \$50, would therefore be payable, and the goods would not be 'screened free'.

5.10 The reasons for having a screen free limit include:

- minimising delays in delivering mail and cargo;
- reducing the cost to business of importing low value consignments;
- determining a value below which it is uneconomical for Customs to collect the tax and duty; and
- to facilitate international trade by minimising Customs intervention.³

5.11 Information about the quantity and value of goods entering Australia under the 'screen free limit' is limited. Customs reported to the Committee that because consignments are screened free there has not been the need, in the past, to collect data on this material.⁴ Without this data, it is also difficult to estimate the duty and sales tax revenue that is not collected. In view of the Committee's investigation, Customs addressed this information deficit by commissioning AC Nielsen to conduct a survey of low value imported goods.

3 Australian Taxation Office, *Submission*, p. S465.

4 Mr John Drury, Australian Customs Service, *Transcript*, 20 October 1997, pp. 28-29.

International comparisons

5.12 Other countries have screen free limits for which they do not collect duty and sales tax on imported goods. Table 5.1 shows the duty and sales tax free limits on imported goods for selected countries. Table 5.2 shows the threshold levels, for selected countries, at which imported goods must be formally entered or reported to Customs.

5.13 In Table 5.2, Australia, Singapore, Japan, and the UK have different thresholds for postal and non-postal items.

Table 5.1: Duty and sales tax free limits on imported goods for selected countries

| Country | Postal imports | Non-postal imports |
|-------------|----------------------------------|----------------------------------|
| Australia | \$50 duty/tax | \$50 duty/tax |
| Canada | CAD\$20 | CAD\$20 |
| Germany | DM 50 (value of goods) | DM 50 (value of goods) |
| Japan | ¥ 10 000 | ¥ 10 000 |
| New Zealand | NZD \$50 duty | |
| Singapore | GST relief of SGD \$400 in value | GST relief of SGD \$400 in value |
| Thailand | THB 500 (value of goods) | THB 500 (value of goods) |
| USA | US \$200 | |

Source: Australia Post. Note: Blank entries indicate no data supplied.

Table 5.2: Threshold levels, for selected countries, at which imported goods must be formally entered or reported to Customs

| Country | Postal imports | Non-postal imports |
|-------------|--|-----------------------------|
| Australia | \$1000 value of goods | \$250 value of goods |
| Canada | CAD\$1600 | CAD\$1600 |
| Germany | DM 1600 (value of goods) | |
| Japan | No threshold | ¥ 200 000 (value of goods) |
| New Zealand | NZD \$1000 | NZD \$1000 |
| Singapore | None, but trade goods generally require a Customs permit | Generally SGD \$400 |
| Thailand | THB 10 000 (value of goods) | THB 10 000 (value of goods) |
| UK | Stg£2000 | Stg£600 |
| USA | US \$1 250 | US \$1 250 |

Source: Australia Post. Note: Blank entries indicate no data supplied.

Australian Customs Administration

Import consignments – quantities

5.14 Customs, with the assistance of Australia Post, provides systems for receiving, assessing and, if necessary, collecting duty and sales tax for air and sea cargo and postal traffic. Management of this exercise is complicated by the large number of consignments which enter Australia every year. For example, in 1997, there were 202.0 million import consignments to Australia. Of this number, 159.6 million were postal articles, 41.5 million were air cargo and 0.9 million were sea cargo.

5.15 Customs screens free the majority of these items. For example, of the 159.6 million postal articles, 145.5 million are letters which are all screened free. Other consignments,

however, could contain items of commercial value which may have a duty and sales tax liability. Table 5.3 shows a breakdown of import consignments by category, volume and entry status.

Table 5.3: All import consignments by category, volume, and entry status, 1997

| Import category | Volume (million) | Formal % | Informal % | Screen free % |
|-----------------|------------------|----------|------------|---------------|
| Postal articles | 159.6 | | | |
| Letters | 145.5 | | | 100 |
| Parcels/OA | 14.1 | <1 | <1 | 99 |
| Air cargo | | | | |
| Courier | 37.5 | — | — | 100 |
| Cargo | 4.0 | 53 | <1 | 47 |
| Sea cargo | 0.9 | 100 | — | — |
| Total | 202.0 | | | |

Source: Exhibit 37: AC Nielsen, *Survey of Low Value Importations*, 25 February 1998, p. 26.

Screening processes and examples

5.16 Imports are made up of air cargo, sea cargo and postal traffic. For the majority of air cargo, Customs receives details of the consignments prior to their arrival either electronically or in documentary form. This information provides Customs with the opportunity to assess the data for revenue or community protection concerns and take appropriate action. If there are no revenue or community protection concerns the cargo is screened free and released on arrival. At present, the screening process is performed manually by a Customs officer checking electronic records.⁵

5.17 It is the responsibility of the importer to assess duty liability. For air cargo, where the value of the good exceeds \$250, a formal entry declaration must be lodged. Where the value of the good is below \$250 but duty and sales tax exceeds \$50 then an informal clearance document (ICD) must be lodged. Customs has a cost recovery policy for processing formal entry declarations. For electronic entries, the fee charged is \$22.80 and for manual entries the fee is \$44.55.

5 Australian Customs Service, *Submission*, p. S136.

There is no charge for ICDs but the cost to process these is estimated at up to \$20.90.⁶ In a later submission, however, Customs estimated the cost of an informal clearance at \$17.90.⁷

5.18 Customs advises that the process for sea cargo is the same except that in most cases, goods are not screened free. This is because most sea consignments have a value exceeding \$250 in which case a formal entry declaration is lodged.

5.19 Postal traffic differs from air and sea cargo in a number of important respects. First, information on postal consignments is not available prior to arrival. Second, postal traffic has a higher incidence of personal or private transactions rather than commercial importations. Third, the commercial (formal) entry threshold for postal items is set at \$1000.

5.20 Customs treatment depends on the category of mail. In relation to parcel post which exceeds 2.0kg in weight, Customs screens all such articles. Assessment is based on the reliability and accuracy of information on the international postal declaration on the parcel and the Customs Officer's assessment of the parcel without opening it. In addition, Customs incorporates physical checks including sniffer dogs, X-rays and, where necessary, physical inspection.⁸

5.21 In relation to letter class and other article (OA) mail up to 2.0kg in weight, Customs employs a process known as the Risk Assessment Profile System (RAPS) which encompasses the drug detector dog unit and a profile of countries to select around 15% of bags of this class of mail that present a risk.⁹ Customs acknowledges that its methods of assessment are often subject to the reliability of information provided. Customs states:

Customs scrutiny of all types of mail is hampered by the paucity of information in relation to each article. Often, the international postal declaration is missing, incomplete or illegible. In other cases, goods are misdescribed and or incorrectly valued. Where a postal declaration has been

6 Australian Customs Service, *Submission*, p. S649.

7 Australian Customs Service, *Submission*, p. S832.

8 Australian Customs Service, *Submission*, p. S136.

9 Australian Customs Service, *Submission*, p. S137.

affixed to the article, there is no declarant in Australia who can be held accountable for the accuracy of the information.¹⁰

5.22 The Customs Brokers Council of Australia (CBCA) commented that 'reliance upon the consignment note, air waybill and manifest data is fundamentally flawed and the Australian Quarantine and Inspection Service has recently made a conscious decision not to use such information in assessing shipments for quarantine functions'. The CBCA concluded that 'as the integrity of such information is suspect its continued acceptance by the ACS provides opportunities for systemic misuse'.¹¹

5.23 The administration of the customs requirements is complicated not just by the volume of goods requiring assessment but also by the difficulty in estimating value and then duty and sales tax. Different goods can have different rates of duty and sales tax which creates different minimum values at which point the \$50 duty and sales tax level is exceeded. Table 5.4 shows some examples of duty and sales tax levels by goods category.

Table 5.4: Minimum value of profiled goods at which the duty/sales tax limit is exceeded

| Goods category | Duty rate | Sales tax rate | Combined rate ⁽¹⁾ | Minimum value |
|------------------------|-----------|----------------|------------------------------|---------------|
| Apparel | 34% | 0% | 34.00% | \$147.06 |
| Auto parts | 15% | 22% | 45.36% | \$110.23 |
| Cassettes | 0% | 22% | 26.40% | \$189.39 |
| CDs | 0% | 22% | 26.40% | \$189.39 |
| Cosmetics | 5% | 22% | 32.72% | \$152.81 |
| Jewellery | 5% | 32% | 45.32% | \$110.33 |
| Photographic materials | 5% | 22% | 32.72% | \$152.81 |
| Toys | 5% | 22% | 32.72% | \$152.81 |
| Sporting goods | 5% | 22% | 32.72% | \$152.81 |
| Watches | 0% | 32% | 38.40% | \$130.21 |

Source: Australian Customs Service, *Submission*, p. S146.

(1) The taxable value of goods is 120% of the sum of the value of the goods and the Customs duty, hence the combined rate is higher than just adding the two rates.

10 Australian Customs Service, *Submission*, p. S137.

11 Customs Brokers Council of Australia, *Submission*, p. S91.

5.24 Table 5.4 shows that the minimum value of a good at which point the duty and sales tax exceeds \$50 can vary. For example, auto parts to the value of \$110.33, will attract duty and sales tax just exceeding \$50. In contrast, the minimum value for CDs is \$189.39. This type of information on high profile goods is available to Customs officers responsible for screening goods. Provided the information on the imported article is correct, Customs officers can determine whether duty and sales tax is required.

5.25 Customs clears over 90% of cargo on the assumption that the documentation supplied and the duty tendered are correct. Penalties for the provision of incorrect information are provided for under section 243T of the *Customs Act 1901*. The 'penalty is equal to twice the amount of the excess, or a penalty of \$20 whichever is the greater'. In addition, a false statement on a Customs Declaration gives rise to a penalty under section 97 of the *Sales Tax Assessment Act 1992*, equal to double the amount of tax avoided.

Australia Post operations

5.26 Australia Post (AP) provides Customs with assistance in assessing postal articles. Customs maintains a dedicated postal barrier function on AP premises. AP supports Customs with this function by bearing accommodation costs and employing 'some 90 postal staff full-time on barrier functions in direct support of Customs activity'.¹²

5.27 Where Customs officers determine that a postal article must be physically examined then, under Australian Postal law, such an article must be opened and closed by AP officers.

5.28 AP commented that the existing arrangements 'have proved to be a practicable and adequate regime for the collection of duty and sales tax on international postal mail'.¹³

12 Australia Post, *Submission*, p. S97.

13 Australia Post, *Submission*, p. S98.

Revenue and cost outlays

5.29 In 1996–97, Customs collected \$3.289 billion in duty and \$619 million in sales tax. Customs advised that their estimates of costs indicates an 'overall cost recovery budget of \$70.8 million'. This amount 'represents the full costs for all Customs activities directly or indirectly related to processing import transactions for air, sea and post'. Transactions include entries, screen free handling and reporting of cargo. Table 5.5 shows a breakdown of the costs incurred and where costs are recovered through charges.¹⁴

Table 5.5: Customs entry related costs

| Activity | Cost (\$m) | Charge |
|--|---------------|---|
| Air/post | | |
| • entry related costs | \$34.3 | Costs recovered through electronic entry charge |
| • screening costs of consignments not requiring an entry | \$4.9 | Costs recovered through screening charge |
| Subtotal | \$39.2 | |
| Sea | | |
| • entry related costs | \$25.1 | Costs recovered through electronic entry charge |
| Other costs | | |
| • refunds, depots, entries ex warehouse | \$3.8 | Costs recovered through refund charge, depot licensing etc |
| Manual transaction costs | \$2.7 | Costs recovered through manual entry and manual reporting charges |
| Total estimated costs | \$70.8 | |

Source: Australian Customs Service, *Submission*, p. S817.

14 Australian Customs Service, *Submission*, pp. S811–817.

5.30 The Government initiated a cost recovery regime through the *Customs Amendment Act (No.2) 1996*. The Act provides charges for the following services:

- the processing of sea and air cargo reports;
- import entry processing for sea, air and post; and
- licensing of approved places for the examination of goods.¹⁵

5.31 The then Minister for Small Business and Consumer Affairs, the Hon Geoff Prosser, MP, stated:

Customs has undertaken detailed activity based costing of its services to ensure that the costs recovered do not exceed the costs calculated to process import transactions...The charges are limited to the calculated costs of delivering the functions, and will be reviewed annually to ensure that they only reflect the actual costs of service delivery. Any efficiencies identified in service delivery will be passed on through lower charges.¹⁶

5.32 Some of the relevant charges applied by Customs at 1 April 1997 are shown in Table 5.6.

Table 5.6: Customs import processing charges applying from 1 April 1997

| Item | Charge |
|--|---|
| Import entry via sea (lodged electronically) | \$29.65 plus \$0.20 per line after line 10 |
| Manual import entry via sea | \$51.40 plus \$1.00 per line after the first line |
| Import entry via air or post lodged electronically | \$22.80 plus \$0.20 per line after line 10 |
| Manual import entry charge via air or post | \$44.55 plus \$1.00 per line after the first line |

Source: Australian Customs Notice, No. 97/15, 20 February 1997.

15 Parliamentary Debates (Hansard), House of Representatives, Customs Amendment Bill (No.2), Second Reading Speech, 7 November 1996, p. 6769.

16 Parliamentary Debates (Hansard), Customs Amendment Bill (No.2), Second Reading Speech, 7 November 1996, p. 6769.

Compliance issues

5.33 Some groups, in evidence to the inquiry, alleged that some importers were failing to comply with Customs requirements. In addition, it was claimed that there were 'loopholes' in which importers could structure their imports to take advantage of the screen free limit.

5.34 The Australian Fishing Tackle Association (AFTA) tendered evidence to the Committee, showing that a Freight Exporting company in Singapore would lower the price of an invoice so that duty fees would be avoided.¹⁷ In another example, AFTA produced a Customs declaration for a consignment of goods valued at \$65. The actual value of the goods was claimed to be US\$987.¹⁸ AFTA also advised that some overseas suppliers would divide a large value order into separate low value consignments so that the goods entered under the screen free limit.

5.35 The issue of multiple consignments was also raised by the Customs Brokers Council of Australia (CBCA). The CBCA advised that certain Customs provisions allow the importation of, for example, a consignment of 900 shirts, with each shirt being a separate contract and falling under the screen free limit.¹⁹

Bar coding

5.36 The Australian Music Retailers Association (AMRA) proposed the introduction of bar coding to improve Customs and Australia Post administration. AFTA supported this and proposed that a bar coding system should include information about the shipper, purchaser and a description and value for the item. Any good that entered Australia without a readable bar code should be charged with an administrative fee of \$30.²⁰

17 Mr John Dunphy, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 90.

18 Mr John Dunphy, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 103.

19 Mr Stephen Morris, Customs Brokers Council of Australia, *Transcript*, 5 November 1997, p. 113.

20 Australian Fishing Tackle Association, *Submission*, p. S193.

5.37 Mr Robert Fox, in his submission, proposed three options involving electronic assessment of imported parcels. For his preferred option, Fox states:

The supplier registers with an international third party organisation which collects supplier registration data and holds all Custom codes. This third party is responsible for keeping categories and codes up to date, for keeping a register of all suppliers, and for collecting tax from suppliers and forwarding it to each country's Customs. A service charge would be deducted from Customs revenue.²¹

5.38 Fox acknowledged that an 'international approach will be desirable'.²²

Conclusions

5.39 During the conduct of this inquiry, the Committee was advised of possible fraudulent importing activities. Second, the Committee was alerted to importing processes whereby large consignments were presented to Customs in such a way that each individual item entered under the screen free limit.

5.40 At the same time that the Committee has been examining these issues the Australian National Audit Office (ANAO) indicated that it was undertaking a preliminary study with a view to determining whether to commence a performance audit of parcel and letter screening by Customs. Should this audit proceed, the Committee considers that the ANAO should examine compliance with Customs importation guidelines and, if necessary, suggest ways that compliance can be improved.

5.41 In addition, the Committee received evidence suggesting that there could be efficiency improvements from the introduction of electronic data scanning of imported goods. Some groups suggested that bar coding could help Australian Customs in processing imported goods, particularly postal traffic. Australia Post and Customs should examine improvements that can be made to bar coding and related identification systems for imported goods.

21 Mr Robert AS Fox, *Submission*, pp. S28-29.

22 Mr Robert AS Fox, *Submission*, p. S29.

5.42 Recommendation 7

The Auditor-General should examine, as part of any performance audit he undertakes into parcel and letter screening, compliance with Australian Customs importation guidelines and possible ways compliance can be improved.

5.43 Recommendation 8

Australian Customs and Australia Post should examine improvements that can be made to, and international progress with, bar coding and related item identification systems for imported goods and advise the Joint Committee of Public Accounts and Audit.

Internet commerce and the screen free limit

5.44 Various retailing groups, in evidence to the inquiry, claimed that, in recent years, more goods were entering Australia under the screen free limit. Further, it was claimed that this increase was due to the sales and purchasing opportunities offered by the internet. AFTA stated:

When we are talking to most of our members they are all saying they are having customers coming in saying and skiting, 'I bought this on the Net. I saved \$50,' or \$100, or whatever. We are getting a lot of information from our members that this is happening. I really think that the Internet trade is bigger than we think. This is having an effect on industry too.²³

23 Mr Brian Hale, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 96.

5.45 Coles Myer had similar concerns:

It is difficult to avoid surmising that, without careful reassessment of our taxation regime, the much anticipated growth of internet trading will adversely effect the Australian retail industry's sales and profit in relation to imports of goods and distribution services via the internet.²⁴

5.46 Some non-retailing groups, however, questioned whether it was possible to attribute loss of market share to the internet. The Industry Commission (IC) doubts whether 'electronic commerce of this type will have a significant impact on the competitiveness of Australian retailers or on the revenue base in the short to medium term.'²⁵

5.47 Further, it was suggested that the opportunities provided by the internet are no different to those available through mail order. Customs presented a consistent line throughout the inquiry that direct mail ordering provided the same opportunities as those provided by the internet. In addition, Customs advised it was not possible for them to determine whether imported goods were ordered on the internet or through direct mail order. Customs stated:

...we do not know if there is growth in, say, fishing tackle or in other sorts of commodities, garments for example, and whether they are getting a kick along because of the internet or because of a fairly hefty mail ordering scheme.²⁶

5.48 Telstra and the Internet Industry Association (IIA) suggested that there were similarities between internet commerce and mail order. Telstra commented that in terms of international transactions, internet commerce is 'no different to what we have been doing with mail order for a long time'.²⁷ The IIA suggested that the existing screen free limit is a

24 Coles Myer, *Submission*, p. S248.

25 Mr John Cosgrove, Industry Commission, *Transcript*, 16 December 1997, p. 473.

26 Mr John Drury, Australian Customs Service, *Transcript*, 20 October 1997, p. 40.

27 Mr Darren Adam, Telstra, *Transcript*, 6 November 1997, p. 215.

response to problems created by mail order. Further, it was an inefficient use of time to focus on imports with duty and sales tax value of less than \$50. The IIA stated:

The way we have dealt with that [mail order] is by reducing the amount of stuff anyone can import to a dollar amount not exceeding, I think \$50. You need to ask yourself whether we should be spending a very large amount of time trying to manage the below \$50 imports that individuals are making as a significant leakage of our tax base or whether in fact we should be looking at the large end of town. The consumer driven electronic commerce is not going to be the most significant factor in this equation. Our projections are that, in the next two to three years, up to 80 per cent of electronic commerce will simply be business to business.²⁸

5.49 Arthur Andersen also commented that 'electronic commerce vis-a-vis CDs and fishing tackle raises no different tax issues to a mail order purchase' of these items.²⁹ Retailing groups, however, responded that there is a danger in making comparisons between mail order and internet shopping. Australian consumers, unlike Americans, are not major users of mail order. The Australian Retailers Association (ARA) stated:

I think that if we make an assumption that Internet home shopping is mail order business in an electronic form we have totally missed the point of what the potential of this is all about. That is the message I get from everybody that I have spoken to around the world on this topic. Internet shopping is not catalogue shopping, mail order shopping, in an electronic form. It is a totally new way of shopping. . . we have one of the best electronic infrastructures about to be in place anywhere in the world, and we have one of the best educated groups of citizens in the world that are increasingly going to take up shopping in this new format.

28 Mr Michael Ward, Internet Industry Association, *Transcript*, 5 November 1997, p. 180.

29 Mr Anthony Stolarek, Arthur Andersen, *Transcript*, 14 November 1997, p. 332.

Price and sales tax

5.50 AFTA and the Jewellers Association of Australia (JAA) indicated that they faced a distinct price disadvantage against imported goods that were not subject to duty and sales tax. The JAA advised that a Seiko Chronograph watch that retails in Australia for \$750 could be purchased over the internet for about US\$275.³⁰ AFTA stated:

We are saying that there is a difference of 26.4 per cent to 32.7 per cent between if goods come into this country and they are non-dutiable, where the sales tax levy equates to a factor of 26.4 per cent, and if the goods are dutiable, where the sales tax and duty factor is 32.7 per cent. That is the difference we are talking about. We are not talking about a difference in margin that we make.³¹

5.51 AFTA, Coles Myer, the Australian Music Retailers' Association (AMRA) and the JAA suggested that their concerns were not solely with the internet but with Australia's wholesale sales tax regime. The JAA commented that they 'find themselves potentially at a huge disadvantage with internet trade, because of the wholesale sales tax system that exists in this country.'³² AMRA commented that wholesale sales tax penalises Australian retailers and 'does not allow companies to meet the growing competition from overseas deliveries'.³³ Similarly, AFTA stated:

For the Australian fishing tackle industry, the issue is not whether the Internet is good or bad, nor the conditions or controls on access by consumers to the Internet. Rather, it is the way the Australian taxation system seriously disadvantages Australian retailers. The real point for a retailer is that he cannot compete with his competitors on the Internet where those competitors have an effective price advantage of around 26 to 33 per cent.³⁴

30 Jewellers Association of Australia, *Transcript*, 20 October 1997, p. 5.

31 Mr John Dunphy, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 91.

32 Mr Chris Reeves, Jewellers Association of Australia, *Transcript*, 20 October 1997, p. 4.

33 Australian Music Retailers' Association, *Submission*, p. S394.

34 Mr Lawrence Webb, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 88.

5.52 AFTA further commented that the most important requirement was the need for a level playing field. They were willing to compete by whatever regulations the government made provided that this applied to all competitors. AFTA argued that a level playing field did not exist if some imports were subject to duty and sales tax and others were not.³⁵ The CBCA also agreed that all imported goods should be treated equally in respect of customs duty and sales tax.

5.53 Coles Myer made a similar statement about the inequity of some groups paying sales tax and others not:

*Sales by domestic retailers of both local and imported product are at prices necessarily inclusive of Wholesale Sales Tax, where applicable. The standard rate is 22 per cent of the wholesale price with some goods exempt, some taxable and others at 32 per cent. When domestic retailers sell Australian products, as they mostly do, similar sales tax is paid. Individual imports of goods sold on the internet, where exempt under the threshold, bear no such cost.*³⁶

5.54 An alternative to proposing that all imported goods should pay duty and sales tax is to eliminate these taxes on imports. Coles Myer suggested that duty concessions should be 'broadened and all sales tax and customs duties are eliminated on imports.'³⁷

5.55 Some retailers argued that certain wholesale sales tax rates should be reduced. The JAA commented that 'the single biggest thing that we think Australia can do in terms of the jewellery industry to combat the threat of internet trading is to reduce quite dramatically the rate of 32 per cent in sales tax on jewellery.'³⁸

5.56 Some groups suggested that abolition of wholesale sales tax and its replacement with a goods and service tax would be fairer. AFTA commented that 'we would all agree that a GST or a similar type of tax would make it a lot fairer across the board, and these taxes should be charged on

35 Mr John Dunphy, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 90.

36 Coles Myer, *Submission*, p. S247.

37 Mr Tom Curtis, Coles Myer, *Transcript*, 14 November 1997, p. 289.

38 Mr Chris Reeves, Jewellers Association of Australia, *Transcript*, 20 October 1997, p. 5.

internet purchases'.³⁹ The JAA commented that 'Australia needs to abolish wholesale sales tax and introduce a retail tax levied at a uniform and acceptable rate'.⁴⁰

5.57 Customs purchased some fishing tackle from overseas to examine prices. It found that even if duty and sales tax had been paid, it was still cheaper to have imported the goods.⁴¹ CAPEC, an industry association that represents express carriers such as DHL, TNT, Federal Express and UPS, made the following comment in relation to Customs' finding that goods could still be cheaper if duty and sales tax had been paid:

*Even if the duty and sales tax were paid, and if it were still cheaper to buy over the internet, there would be no benefit to the retailers; they would still lose the sale. The consumer then would have to pay the duty and sales tax. The consumer then would also probably be burdened with Customs cost recovery charges, and there would be no benefit to the Australian manufacturing sector or to any sector in Australia.*⁴²

Proposals to change the screen free limit

5.58 Retailing organisations, in evidence to the inquiry, suggested that the internet would lead to an increase in imported goods under the screen free limit. These groups argued that there was no equity in this situation because not all recipients of imported goods were paying duty and sales tax.

39 Mr Brian Hale, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 97.

40 Jewellers Association of Australia, *Submission*, p. S57.

41 Mr Graeme Austin, Australian Customs Service, *Transcript*, 20 October 1997, p. 40.

42 Mr Ken Muldoon, CAPEC, *Transcript*, 5 November 1997, p. 140.

5.59 To address these concerns, the key proposal by retailing groups was to lower or remove the screen free limit. AFTA stated that it 'seeks removal of discretion to exempt imported goods from sales tax or import duties in circumstances where the value of the imported goods do not raise a tax/duty liability of more than \$50.'⁴³

5.60 AFTA was supported by the Boating Industry Association of Australia⁴⁴. Coles Myer proposed that the duty and sales tax free limit should be reduced to \$20 and the commercial entry thresholds be harmonised at \$250.⁴⁵ Coles Myer stated:

Whatever long-term solutions may be devised, the fact is that action in the short term is becoming increasingly urgent. Coles Myer believes that denial of the benefit of the threshold to commercial consignments is an early step which needs to be taken and it appears that additional personnel in the assessment activity would generate far more revenue than they would cost, as well as making a material contribution to community protection.⁴⁶

5.61 The Australian Music Retailers' Association (AMRA) and the Institute of Chartered Accountants in Australia called for a review of the screen free limit.⁴⁷ The CBCA made the following statement with respect to the current importation processing system:

...the existing customs duty and sales tax threshold and commercial entry requirements should be removed and all consignments entering Australia be formally entered utilising the ACS electronic capabilities.⁴⁸

43 Australian Fishing Tackle Association, *Submission*, p. S192.

44 Boating Industry Association of Australia, *Submission*, p. S39.

45 Coles Myer, *Submission*, p. S618.

46 Coles Myer, *Submission*, p. S248.

47 Australian Music Retailers Association, *Submission*, p. S394; Institute of Chartered Accountants in Australia, *Submission*, p. S400.

48 Customs Brokers Council of Australia, *Submission*, p. S91.

5.62 The CBCA argues that revenue in the order of \$12 to \$50 million currently lost to the government would be collected if the \$50 duty and sales tax free limit was abolished.⁴⁹

5.63 Australia Post and Customs provided data showing the revenue and cost implications of reducing the duty and sales tax free limit to a range of amounts under \$50. This information is shown in Table 5.7.

Table 5.7: Effects of different duty and sales tax free limits

| POSTAL TRAFFIC | | | | | |
|--------------------------------|------------------|--------------|---------------|---------------|---------------|
| Duty and sales tax free limits | Greater than \$0 | \$10 | \$20 | \$30 | \$40 |
| Consignments affected | 261 000 | 161 000 | 106 000 | 64 000 | 27 000 |
| Additional revenue | \$3.9m | \$3.5m | \$2.8m | \$2.0m | \$1.2m |
| Additional costs | | | | | |
| Customs | \$4.7m | \$2.9m | \$1.9m | \$1.2m | \$1.0 |
| Australia Post* | | \$1.3m | \$1.0 | \$0.5 | \$0.2 |
| Total | | \$4.2 | \$2.9m | \$1.7m | \$1.2m |

Australia Post figures do not include 'allocated overheads'.

| AIR CARGO | | | | | |
|-----------------------|----------------|---------|---------|-----------|-----------|
| | Greater than 0 | \$10 | \$20 | \$30 | \$40 |
| Consignments affected | 689 000 | 246 000 | 147 000 | 45 000 | 17 000 |
| Additional revenue | \$5.9m | \$4.8m | \$3.6m | \$1.4 | \$618 000 |
| Additional costs | \$8.3m | \$3.0m | \$1.8m | \$542 000 | \$202 000 |

Source: Australian Customs Service, *Submission*, pp. 824-825.

49 Customs Brokers Council of Australia, *Submission*, p. S92.

5.64 Customs advised that there are additional costs that are not shown in Table 5.7. These costs include:

- Australia Post would incur storage and staff costs as a result of the increased number of consignments held pending clearance and payment;
- a greater number of importers of both air and postal cargo would be required to complete Customs formalities;
- in the postal environment, importers would be required to attend international mail centres to complete customs formalities;
- if the duty and sales tax free limit was to be reduced, the cost recovery charge would comprise an increasingly greater proportion of the importers' total liability; and
- a reduction in the duty and sales tax free limit for air, sea and postal goods would also place pressure on the existing passenger concession, which is also set at \$50.⁵⁰

5.65 Both Customs and Australia Post warned that removing the screen free limit could have significant administrative cost implications.⁵¹ Customs stated:

*A reduction in the duty and sales tax free limit may result in a significant increase in the number of postal and air consignments required to be held pending payment of duty and/or sales tax. It could also have significant resource implications for Customs which could lead to the cost of collecting any additional Customs duty and sales tax being greater than the amount of any additional revenue collected.*⁵²

5.66 Customs has proposed that the duty and sales tax free limit of \$50 be replaced with a screen free 'goods value' limit of \$150. Customs claims that this would result in 'increased efficiency in the screening and duty assessment procedures as officers would decide the treatment of such

50 Australian Customs Submission, *Submission*, p. S826.

51 Australia Post, *Submission*, p. S97.

52 Australian Customs Service, *Submission*, p. S135.

goods on the value only of the goods'.⁵³ Customs advises that Germany (50DM), Singapore (\$400) and Thailand (500baht) employ a screen free limit based on goods value.⁵⁴

5.67 A range of organisations commented on this proposal. The Industry Commission (IC) suggested that there could be an incentive for importers to undervalue their goods so that they enter under the \$150 level. This concern is weighed against Customs' claimed administrative efficiencies with the IC concluding that 'the risk of increased evasion is likely to be a minor problem'.⁵⁵

5.68 The CBCA 'agrees in principle' with Customs' proposal to have a screen free value limit of \$150. The Australian Fishing Tackle Association, (AFTA) disagreed and stated:

*...ACS cannot operate a clearance system that places blind faith in a \$150 limit. It can only operate if the shipper correctly values the items and displays that on the parcel...undervaluing of parcels is a serious, and growing problem.*⁵⁶

5.69 CAPEC supported the move to a screen free system based on value of a good but requested 'that consideration be given to increasing this customs value limit to \$200 or \$250'.⁵⁷

5.70 The World Trade Organisation (WTO) and the OECD have both discussed the delivery of physical goods as part of inquiries into electronic commerce.⁵⁸ Both these organisations suggest that off-line delivery of goods is inefficient and could be a barrier to electronic commerce. The

53 Australian Customs Service, *Submission*, p. S814.

54 Australian Customs Service, *Submission*, p. S834.

55 Industry Commission, *Submission*, p. S844.

56 Australian Fishing Tackle Association, *Submission*, pp. S845-846.

57 CAPEC, *Submission*, p. S853.

58 World Trade Organisation, *Electronic Commerce and the Role of the WTO*, WTO Publications, Geneva, 1998, p. 33; OECD, *Dismantling the Barriers to Global Electronic Commerce*, Turku, Finland, 1997, p. 25, [www.oecd.org/dsti/sti/it/ec/prod/DISMANTL.HTM].

OECD discussed survey findings that show that for on-line consumers the most important criterion 'is timely delivery of goods'.⁵⁹ The WTO stated:

*Costs such as insurance and shipping and customs administration can reach or even exceed the value of the product itself. Unless shipping and administration become much easier and cheaper, cross-border transactions of this kind may experience limited growth.*⁶⁰

5.71 To address inefficiencies in the delivery of physical goods, the OECD suggested that 'countries should consider expanding tax and duty-free thresholds to simplify the arrival of low-value shipments, especially where the administrative cost to government exceeds the tariff revenue'.⁶¹ The WTO also proposed this option.⁶²

The commercial entry thresholds

5.72 The Committee received evidence about the appropriateness of the commercial entry thresholds. CAPEC supported a harmonisation of the thresholds at \$1500 and also commented that 'anecdotal evidence suggests that a figure of \$2000 may be appropriate for ABS purposes'.⁶³ The ABS does not collect data on imports that are lodged by informal clearance document. Customs advised that the ABS 'has indicated that, in principle, it has no requirement for extensive data on low value goods'.⁶⁴

5.73 Australia Post called for the harmonisation of the thresholds and an increase in the level up to \$1500.

59 OECD, *Dismantling the Barriers to Global Electronic Commerce*, p. 24.

60 World Trade Organisation, *Electronic Commerce and the Role of the WTO*, p. 33.

61 OECD, *Dismantling the Barriers to Global Electronic Commerce*, p. 25.

62 World Trade Organisation, *Electronic Commerce and the Role of the WTO*, p. 33.

63 CAPEC, *Submission*, p. S850.

64 Australian Customs Submission, *Submission*, p. S822.

5.74 AFTA rejected the proposal to raise the combined commercial entry thresholds to \$1000, and warned that the 'implications of this proposal are horrific to the Australian economy'.⁶⁵

5.75 Customs indicated that changes to the commercial entry thresholds would affect the number of ICDs and formal entry declarations:

- if the entry thresholds are raised, the number of formal entry declarations will decrease and the number of informal clearances will increase;
- if entry thresholds are lowered, the number of formal entry declarations will increase and the number of informal clearances will decrease.⁶⁶

5.76 There is a Customs requirement to provide a formal entry declaration if the value of a consignment is above the postal threshold of \$1000 or the non postal threshold of \$250. Customs receives revenue from formal entries. For example, for air or postal consignments, \$22.80 is charged for an electronic entry and \$44.55 for a manual entry.

5.77 Customs indicated that raising the thresholds will result in fewer formal entries and more informal clearance documents. In this event, Customs advised that the manual paper based informal clearance document (ICD) system would need to be replaced with an electronic system specifically designed for that purpose. In addition, Customs advised that it would be necessary to consider cost recovery charges for ICDs.⁶⁷ Customs estimates that the cost of an electronic ICD could be in the range of \$10 to \$12 which is considerably lower than a formal entry declaration electronic lodgement of \$22.80.⁶⁸ Currently, the estimated cost of a paper based ICD, which is not currently charged, is \$17.90.

65 Australian Fishing Tackle Association, *Submission*, p. S190.

66 Australian Customs Service, *Submission*, p. S814.

67 Australian Customs Service, *Submission*, p. S650 and p. S814.

68 Australian Customs Service, *Submission*, p. S831.

5.78 The CBCA has acknowledged the need for an electronic process for ICDs and for a user fee.⁶⁹ In previous reviews, the CBCA commented that a formal entry declaration was more cost effective than clearance by ICD.⁷⁰

Flat entry fee proposal

5.79 Some groups proposed that a flat entry fee be introduced for all imported goods. The purpose of the flat entry fee is to remove, as far as possible, the price differential between domestic goods and imported goods that are not subject to duty and sales tax.

5.80 AFTA commented that all imported items, whether through Australia Post or any other means, should be subject to a collection fee at the point of entry 'whether it is \$50 or \$60'.⁷¹ AFTA did acknowledge that there should be some way to avoid these costs if it could be proven that an item was a gift. East Coast Antique Auto Parts suggested that there should be a '\$50 bounty placed on goods coming in from overseas under the \$250 threshold'.⁷² The ARA stated:

*...every product that comes in you charge a tax on, whether it is a gift or whatever it is, and it is up to the recipient or the purchaser of that product to demonstrate that they should not have had to pay that. All I am saying is we have to think about things in a very different way from the way we traditionally do it; otherwise this thing is going to get right out of control.*⁷³

5.81 Groups proposing a flat entry fee for imported goods are suggesting that this would create a disincentive for Australian consumers to import low value goods. The IC agrees that a flat entry fee may discourage small purchases,

69 Customs Brokers Council of Australia, *Submission*, p. S835.

70 Customs Brokers Council of Australia, *Submission*, p. S840.

71 Mr Lawrence Webb, Australian Fishing Tackle Association, *Transcript*, 5 November 1997, p. 102.

72 East Coast Auto Part, *Submission*, p. S42.

73 Mr David Shetliffe, Australian Retailers Association, *Transcript*, 5 November 1997, p. 132.

but it could also have the reverse impact of 'encouraging the bundling of purchases into commercial sized lots to minimise the average incidence of the flat fee'.⁷⁴

Australia Post and ABS data

5.82 Some retailing groups claimed that internet commerce has led to an increase in imported goods under the screen free limit. Further, it was claimed that this was having an impact on the sales figures of some retailing groups.

5.83 Aggregate data from Australia Post, while lacking detail about type of good, does not lend support to the claims by some retailing groups. If the claims by retailing groups are correct then it would be expected that parcel and packet volumes entering Australia would have increased in recent years. Australia Post, however, advised that 'parcel and packet volumes entering Australia annually over the past six years through our system have remained relatively static'.⁷⁵

5.84 AFTA advised that 'sales of fishing tackle equipment is down on average by some 15%' with some operators reporting 'downward trends of up to 30%'.⁷⁶

5.85 Australian Bureau of Statistics (ABS) data shows that, in the period 1991-92 to 1996-97, imports of dutiable fishing rods and reels have risen from \$18 million to \$32 million, a rise of 78% in five years. In volume terms, the number of rods more than doubled in those five years, while the number of reels increased by 50%. The ABS commented that 'imports of rods and reels rose particularly strongly in 1996-97, up 22% in value terms on the previous year'.⁷⁷

74 Mr John Cosgrove, Industry Commission, *Transcript*, 16 December 1997, p. 473.

75 Mr Gerry Ryan, Australia Post, *Transcript*, 14 November 1997, p. 271.

76 Australian Fishing Tackle Association, *Submission*, p. S185.

77 Australian Bureau of Statistics, *Submission*, p. S543.

5.86 The ABS, however, noted some qualifications in interpreting these results and suggested that the only way to fully understand what was occurring was through a household survey. The ABS stated:

*The ABS does not have sufficient information to interpret these imports data in terms of any significance for the contention that consumers may be importing greater volumes of fishing tackle in small consignments below thresholds. The increase in dutiable imports has been quite large, providing prima facie evidence contrary to the contention. However, it may be that the total level of angling activity has grown even more strongly and screen-free imports levels are also rising. Even then, linking any such incidence to the advent of electronic commerce is not obvious and might arise from an increased level of genuine gifts, from increased numbers of Australians travelling abroad and returning with the goods, from increased mail-order businesses.*⁷⁸

AC Nielsen survey data

5.87 During November 1997, AC Nielsen, on behalf of Customs, conducted a survey into low value importations below the screen free limit. The results are essential for determining the appropriateness of the existing duty and sales tax free limit and the commercial entry thresholds, and for considering the implications of altering the thresholds.

5.88 The remaining sections will review the:

- survey methodology;
- quantity and type of goods screened free;
- fishing tackle and jewellery imports;
- revenue forgone;
- revenue leakage; and
- the cost to collect lost revenue.

78 Australian Bureau of Statistics, *Submission*, p. S543.

Survey methodology

5.89 The AC Nielsen survey design is comprised of three stages.⁷⁹ Stage one, a scoping study, identified Custom's information needs, available data and information deficit areas.

5.90 Stage two was the pilot test survey conducted in Sydney during November 1997. This multi-stage stratified survey involved the selection of 4 107 postal and screen free air cargo consignments over a two week period. Of these consignments, 2 331 were opened.

5.91 Revenue liability was determined by examining the Customs declaration attached to consignments, and also from an examination of the contents of consignments that were opened. This provided for the comparison of 'declared' information with 'actual' information.

5.92 The objectives of the pilot test survey were to:

- test sampling and operational procedures;
- provide data for the JCPAA inquiry; and
- refine the total survey design.⁸⁰

5.93 AC Nielsen made some observations about the accuracy and reliability of the survey results. First, the survey makes inferences for the whole of 1997. The survey, however, was conducted during November 1997 and, therefore, the influence of seasonal factors affecting imports may not be apparent. Nielsen's acknowledged that a high proportion of gifts come through the mail in November.⁸¹ Second, Nielsen's suggested that the relative standard error (RSE) of 4.6% is higher than preferred. It is expected that an RSE of around 2% will be achieved for the stage three survey.

5.94 Coles Myer raised concerns about the survey claiming that the survey questions and results appear to be based on a number of assumptions which 'may not be accurate'.⁸²

79 AC Nielsen – *Survey of Low Value Importations, Report on Stage 2: Pilot Test Survey*, Exhibit 37.

80 AC Nielsen, *Exhibit 37*, p. 3.

81 AC Nielsen, *Exhibit 37*, p. iv.

82 Coles Myer, *Submission*, p. S848.

5.95 Stage three, yet to be undertaken, is the final survey. The design will be similar to that used for stage two but will cover all States and all months of the year. It is expected that the sample size will be in the order of 18 000 to 20 000 consignments.

The quantity and type of goods screened free

5.96 During 1997, it was inferred from survey data that 9.48 million consignments entered Australia under the screen free limit. This number consists of 7.58 million postal consignments and 1.90 million air cargo consignments.⁸³ Sea cargo is not a major contributor because the majority of sea consignments have a value exceeding \$250 and so would not be screened free.

5.97 The main type of goods under the screen free limit, with a known stated revenue liability, were textile, clothing and footwear (TCF) articles (26%). TCF was followed by recording media (19%) and printed matter (15%).⁸⁴

Fishing tackle, CDs and jewellery imports

5.98 Customs advised that the survey showed that imports of fishing tackle, CDs and jewellery under the screen free limit 'was very low'.⁸⁵ Customs reported the following results:

- CDs represented less than 2% of consignments;
- fishing tackle represented less than 0.05%; and
- jewellery represented less than 1%.⁸⁶

5.99 Customs noted that the survey was subject to seasonal variation, with a higher proportion of gifts during November, and, therefore, 'is not necessarily representative'.⁸⁷

83 Australian Customs Service, *Submission*, p. S701.

84 AC Nielsen, *Exhibit 37*, p. iii and p. 36.

85 Australian Customs Service, *Submission*, p. S812.

86 Australian Customs Service, *Submission*, p. S812.

87 Australian Customs Service, *Submission*, p. S812.

Revenue forgone

5.100 The estimated amount of revenue to the Commonwealth that is forgone, because of the existing screen free limit, is \$34 million based on stated or declared value. The potential revenue liability, based on actual physical examination, is \$41 million.

Revenue leakage

5.101 A proportion of consignments screened free have an actual duty and sales tax liability exceeding \$50. Therefore, these items should not have been screened free. These items result in revenue leakage. For 1997, total revenue leakage was estimated at \$26.4 million which is made up of air cargo and postal traffic.

5.102 The survey suggested a potential revenue liability of \$5.8 million for air cargo. Revenue is not collected on 1.8% of all air cargo consignments due to incorrect screening decisions.

5.103 For postal traffic, \$20.6 million of potential revenue is not collected. Incorrect screening decisions accounts for \$15.5 million and the remaining \$5.1 million is due to the current policy of screening only 15% of postal 'other article' traffic.

5.104 The Australian Taxation Office (ATO) addressed the issue of the customs screen free limit in recommendation 26 of its report *Tax and the Internet*.⁸⁸ The ATO recommended that Customs should 'benchmark the current revenue leakage resulting from imports of goods tax and duty free under the concessions for goods of insubstantial or negligible value and to put in place a process to closely monitor the growth of

88 Australian Taxation Office, *Tax and the Internet*, Recommendation 26, p. 127.

activity in this area'.⁸⁹ The ATO commented that where 'an unacceptably high revenue leakage is identified, Customs and the ATO should jointly develop a range of policy and procedural responses for consideration by Government'.⁹⁰

5.105 The ATO was not convinced that imposing duty or sales tax and or administrative fees would have a positive affect on tax revenue. The ATO stated:

*It should also be noted that any move to impose duty and sales tax, and/or to impose 'administrative fees' for entry or clearance of the goods, will not necessarily increase revenue – it may merely reduce the level of activity as a result of the impact on the overall cost of goods purchased in this way.*⁹¹

The cost to collect lost revenue

5.106 Customs advised the Committee that if it was required to collect all duty and sales tax below the \$50 screen free limit, then Customs would need to spend an additional \$81 million per year. This is based on the assumption that all 7.9 million postal articles (includes approximately 300 000 postal articles requiring formal entry declaration) are opened at a cost of \$10.31 each. The extra revenue gained would be in the order of \$67 million which comprises \$41 million revenue forgone and about \$26.4 million of current revenue leakage.

5.107 The CBCA argues that the administrative costs required to collect revenue under the \$50 level would not be as high as that claimed by Customs. The CBCA points out that Customs has not used its 'concept of risk assessment' in arriving at an administrative cost if the screen free limit was

89 Australian Taxation Office, *Tax and the Internet*, Recommendation 26, p. 127.

90 Australian Taxation Office, *Tax and the Internet*, p. 127.

91 Australian Taxation Office, *Tax and the Internet*, p. 127.

abolished.⁹² The CBCA suggests that much of the work in collecting this revenue could be done by Customs Brokers. The CBCA states:

*Currently, any duties and sales tax that are paid on imports are funnelled through a group of customs brokers and freight forwarders that are numbered in the high hundreds. For Customs to collect \$30 million, I would think they might have to spend \$2 million per annum to fix their system to collect it. Once it is set up, the mechanism is in place, and I disagree with their statement that it is going to cost them too much to recover that sort of money. It is not they who are going to do the work.*⁹³

5.108 The CBCA's proposal addresses non-postal traffic. Customs receives data on non-postal consignments prior to their arrival. This facilitates the processing of these types of imports. This type of information is generally not received for postal consignments which arrive at the customs barrier without any prior information. It is not surprising then the majority of revenue leakage, estimated at \$20.6 million, is from postal consignments.

Conclusions

5.109 Some Australian retailing groups advised the Committee that their viability was under threat from a combination of the screen free limit, an uncompetitive wholesale sales tax regime and the growth in internet commerce. It was claimed that the internet would lead to an increase in consumers taking advantage of the screen free limit. Second, Australian retailers argued that they could not compete against imported goods that were not subject to duty and sales tax. These groups suggested that if internet commerce reached its expected potential then the screen free limit would be exploited and would result in an unlevel playing field.

92 Australian Customs Service, *Submission*, p. S837.

93 Mr Kent Heazlett, Customs Brokers Council of Australia, *Transcript*, 5 November 1997, p. 115.

5.110 The Committee has carefully examined the claims made by some retailing groups. The Australian Retailers Association, Coles Myer, the Australian Fishing Tackle Association (AFTA), the Australian Music Retailers Association and the Jewellers Association of Australia all registered concerns that internet trading and the operation of the screen free limit could pose serious concerns for the viability of some parts of the retailing industry.

5.111 In assessing these claims, the Committee was immediately struck with a dearth of information on the quantity, value and type of goods entering Australia under the screen free limit. The Committee's inquiry ensured that the Australian Customs Service (Customs) conduct a survey of low value imported goods under the screen free limit.

5.112 The survey results and other data are not consistent with the claims made by various retailing groups. First, Australia Post statistics show that parcel and packet volumes entering Australia annually over the past six years have remained relatively static. The Committee accepts that this is a broad indicator as there could have been falls in some goods and growth in others during the six year period. However, the Committee finds it surprising that there has not been some discernible growth in parcel and packet volumes entering Australia during the last two years.

5.113 Second, the Australian Bureau of Statistics (ABS) provided information about the importation of dutiable fishing tackle. This example is used because AFTA claimed that some of its operators had reported downward trends in sales of between 15 to 30%. The Committee reasons that if this downward trend in sales was due to a growth in imports entering Australia under the screen free limit then, correspondingly, there would be a reduction in the volume of dutiable imported fishing tackle.

5.114 The ABS found that, in the period 1991-92 to 1996-97, imports of dutiable fishing rods and reels have risen from \$18 million to \$32 million, a rise of 78% in five years. In volume terms, the number of rods more than doubled in those five years, while the number of reels increased by 50%. Again, these statistics can be interpreted in different ways. For example, it is possible, as the ABS suggests, that the total level of angling activity has grown. In that case, there may also have been similar growth in fishing tackle entering Australia under the screen free limit. However, this was not shown by the AC Nielsen survey.

5.115 The AC Nielsen Survey data used for this inquiry is from stage two of a three stage survey. It was a multi-stage stratified sample involving the selection of 4 107 postal and screen free air cargo consignments over a two week period during November 1997. The survey showed that importations of fishing tackle, CDs and jewellery under the screen free limit were 'very low'. Again, it is possible to criticise the survey based on the size of the sample frame and the survey period of only two weeks. However, the Committee argues that it would be rash to radically reduce the duty and sales tax free limit without any evidence showing a significant increase in imported goods under the screen free limit.

Customs duty and sales tax free limit

5.116 In view of the survey evidence, the Committee recommends that the \$50 duty and sales tax free limit not be reduced. The Committee has reviewed Table 5.7 in which some costs and benefits of incremental reductions to the duty and sales tax free limit are shown. The projections show no significant gains in revenue and in some cases additional costs would exceed revenue. At the same time, storage costs for Australia Post would increase, and additional administrative complexities for importers would be introduced.

5.117 Australian Customs proposed that the \$50 duty and sales tax free limit be replaced with a \$150 'goods value' limit. The Committee has considered a number of costs and benefits of introducing a screening system based on a goods value limit of \$150.

5.118 First, there could be an incentive for importers to undervalue their goods so that they are just below \$150. The Committee notes that a similar incentive already exists for importers to value their consignments just below \$250 or \$1000 so they are not subject to the cost of a formal entry declaration. Customs would need to closely monitor import patterns to determine whether there was an increase in goods coming in just below the \$150 mark. The Industry Commission (IC) addressed this issue and concluded that,

based on Customs data, administrative efficiency savings could be in the order of \$9 to 12 million. The IC concluded that the 'risk of increased evasion is likely to be a minor problem'.⁹⁴

5.119 Second, if the wholesale sales tax scheme is radically changed then there will be the need to adjust the \$150 screen free goods value figure. For example, if a goods and services tax (GST) is introduced, the combined rate of duty and sales tax will be lower than it is now. For example, under the current system an average combined rate of duty and sales tax is about 35%. This would equate to a minimum value of \$142 at which point the \$50 duty and sales tax free limit was exceeded. Under a GST, the combined rate of duty and sales tax would be closer to 20%. Using this percentage the minimum value at which point the \$50 duty and sales tax cuts in would be about \$250. Therefore, if a GST was introduced, there could be a case for raising the screen free goods value limit to a more appropriate level.

5.120 The Committee recommends that a decision on introducing a \$150 goods value limit be deferred until the results are available from the stage three survey into low value goods. At this time, the Australian Government should, using that data and other relevant information, consider whether to change the \$50 duty and sales tax free limit to a \$150 goods value limit.

Revenue forgone

5.121 The Committee, in recommending the retention of the duty and sales tax free limit at \$50, acknowledges that potential revenue to the Commonwealth is forgone. The AC Nielsen survey results show that revenue forgone during 1997 is in the order of \$34 million based on stated or declared value or \$41 million based on actual physical examination. The figure of \$34 million revenue forgone works out at 0.87% of total duty and sales tax revenue collected during 1996-97.

5.122 If the Government decided to collect duty and sales tax revenue on goods under the screen free limit, it would, on Customs calculations, need to outlay an additional \$81.44 million. This is the cost of opening up 7.6 million postal parcels that are currently screened free. The extra revenue

gained would be about \$67 million which comprises about \$41 million revenue forgone and about \$26 million revenue leakage.

5.123 The Committee accepts the principle behind and reasons for the screen free limit described in paragraph 5.6. It would be uneconomical for Customs to collect revenue under the screen free limit. However, the Committee believes that the Customs figure of \$81.44 million is not realistic because Customs would never be expected to open up every postal parcel. The estimate does not take into account risk assessment processing.

5.124 If the screen free limit was removed, Customs would check the duty and sales tax liability of consignments by existing methods. At the same time, the Committee accepts that Customs' ability to reduce the amount of revenue forgone and revenue leakage would be reduced.

5.125 Therefore, the additional costs to collect duty and sales tax for non-postal consignments may not be as high as Customs suggests. The Customs Brokers Council of Australia suggested that much of the work could actually be undertaken by their members. However, this would not solve the problem of collecting duty and sales tax on postal items where there is no prior information available. It is in the area of postal consignments where the majority of revenue leakage occurs (\$20.6 million).

5.126 Some members of the Committee inspected Customs operations and screening processes at Melbourne's Tullamarine Airport. While this was a cursory examination, the Committee was struck by the subjectivity of decision making regarding the processing of electronic airwaybills. Second, there were no feedback mechanisms to alert Customs officers of the accuracy of their decision making.

5.127 The Committee concludes that the Auditor-General should review the level of revenue leakage, and examine ways in which screening methodology and importer compliance could be improved.

94 Industry Commission, *Submission*, p. S844.

The commercial entry thresholds

5.128 Currently, thresholds for post and non-postal consignments are set at \$1000 and \$250 respectively. The Committee recommends that the commercial entry thresholds be harmonised at \$1000. Postal and non-postal consignments should be subject to the same importation requirements.

5.129 Raising the non-postal threshold to \$1000 will provide advantages for small business because goods valued between \$250 and \$1000 that previously required formal entry declarations will no longer require this. Customs advises that an electronic process for informal clearance documents (ICD) will be introduced with a possible cost recovery charge in the order of \$10 to \$12. Under this scenario, postal items of less than \$1000 value would, for the first time, be subject to a cost for ICDs.

5.130 The Committee is opposed to the introduction of a charge for ICDs. If the commercial entry thresholds were harmonised at \$1000, Customs advised that there would be 77 000 additional ICDs for non-postal-traffic. There would be no change for postal traffic as the threshold is already at \$1000. If a charge of \$10 was applied to ICDs then this would only generate \$777 000. The Government should absorb this cost. If this advice is accepted and a charge for ICDs is not introduced then the Committee warns Customs that it should not increase the cost of formal entry declarations to cover the cost of ICDs.

5.131 Harmonisation of the thresholds is consistent with arrangements in other countries. The Committee's conclusion is supported by previous research conducted by the Industry Commission and the National Competition Council. Both these groups argue that the current difference between thresholds for post and non-post consignments artificially distorts the transport mode in favour of post.

5.132 The Committee would support raising the commercial entry thresholds to \$1500 if there are no adverse findings from the stage three survey into low value imported goods.

5.133 The Committee accepts that some retailing groups may be disappointed with these recommendations. The Committee, however, could find no evidence to indicate, at this stage, that goods ordered from the internet have been flooding

into the country under the screen free limit. At the same time, the survey results show no reason why the thresholds can not be harmonised at \$1000 immediately. The Committee acknowledges that some concerns have been raised about the survey methodology. These concerns should be eliminated with the stage three survey.

5.134 The Committee proposes the following strategy to monitor and manage the screen free limit:

- **Stage three survey:** Customs should immediately proceed with the third stage of the survey into low value imported goods. The right to conduct this survey should be determined by Australian Public Service tender procedures. One place on the coordinating committee responsible for conducting the survey should be reserved for a representative of the retailing industry.
- **Ministerial determination:** In twelve months, at the completion of the stage three survey, relevant Ministers should confirm the appropriateness or otherwise of the duty and sales tax free limit and the commercial entry thresholds.
- **Improving compliance:** Australian Customs should develop improvements in screening processes to reduce the amount of revenue leakage which is estimated at \$26.4 million per year. The ANAO may wish to examine this issue as part of its future audits. Some possibilities could include monitoring blitzes in which Customs advertises that it will, for a brief and undisclosed period, be inspecting and valuing certain goods. These types of blitzes could be conducted randomly throughout the year and focus on specific goods such as fishing tackle and jewellery. This could provide importers with an incentive to ensure that their imported goods are accurately valued. In addition, a range of new penalties could be introduced if goods are found to be undervalued.

5.135 The Committee acknowledges that internet commerce is in its early stages and, with its growth, import patterns could vary. This requires a constant need to monitor the importation of goods under the screen free limit. The stage three survey will help to achieve this. Customs, however, must establish an ongoing data series which records statistical

information on the quantity, value and type of goods entering Australia under the screen free limit. This data series will need to be built into administrative processes. The ANAO may wish to review Customs' actions. The Australian Government must have a reliable and accurate source of information from which it can make informed policy decisions regarding the impact of the screen free limit, revenue forgone and revenue leakage.

5.136 Finally, the Committee suggests that as internet commerce develops, trade in services will dominate and there will be a focus on goods that can be converted into digital format. These types of goods and services can be ordered and delivered electronically and will be customs duty free.

5.137 Recommendation 9

The customs duty and sales tax free limit should remain at \$50.

5.138 Recommendation 10

The commercial entry thresholds for both postal and non-postal consignments should immediately be set at \$1000.

5.139 Recommendation 11

The Auditor-General should review the level of revenue leakage from customs screening, and suggest ways in which screening methodology could be improved.

5.140 Recommendation 12

Australian Customs should proceed with stage three of the survey into low value imported goods and ensure that:

- (a) *the right to conduct the survey is determined according to Australian Public Service tender procedures; and*
- (b) *a representative of the retailing industry is on the coordinating committee for the survey.*

5.141 Recommendation 13

When the results are available from stage three of the survey into low value imported goods, the Australian Government should, using that data and other relevant information, consider whether to change the \$50 duty and sales tax free limit to a \$150 goods value limit.

5.142 Recommendation 14

Australian Customs must:

- (a) *establish an ongoing data series which records statistical information on the quantity, value and type of goods entering Australia under the screen free limit; and*
- (b) *publish this data in the Australian Customs Service annual report.*

6

GROWTH OPPORTUNITIES FOR AUSTRALIAN SMEs

Introduction

6.1 Internet commerce is being heralded as a new dimension in domestic and international trade of goods and services. In response to this, a range of reports by government, industry and international organisations have outlined the opportunities and challenges, and the strategies that are needed to ensure that internet commerce will flourish.

6.2 One of the key conclusions is the need for a stable regulatory environment that gives business and consumers confidence in such areas as security, privacy, intellectual property, copyright and taxation. The broad theme of recent reports is for the private sector to lead and for government involvement to be minimal. For example, the Australian Government stated that 'the driving force for the information economy is the private sector responding to market forces'.¹

6.3 This Chapter examines progress with achieving a stable regulatory environment. In addition, information has been sought on the knowledge, awareness and willingness of Australian small and medium enterprises (SMEs) to use the internet as part of their business plan. The Chapter also examines the activities of government in assisting SMEs to improve market knowledge and awareness of the opportunities and challenges created by internet commerce.

1 The Howard Government's Plan for Australian Industry, *Investing for the Growth*, December 1997, p. 68.

International SME initiatives

6.4 SMEs are widely recognised as critical to, and significant potential beneficiaries of, growth in electronic commerce.² Yet, they are lagging behind large organisations in the uptake of modern communication technologies.³ Booz-Allen and Hamilton, however, suggest that the opportunities for SMEs are favourable. The smaller, simpler and more flexible structures of SMEs can make adapting to new communication technologies easier than in big companies, and the benefits can be especially rewarding.⁴

6.5 Many governments and international organisations have introduced measures to increase SME awareness, uptake and involvement in electronic commerce. These measures are primarily intended to promote awareness of the potential benefits of internet commerce.

Japan

6.6 In 1994, the Japanese Government recognised that Japanese usage rates for information and communication technologies were considerably less than those in the US. To address this, the Japanese Government introduced various strategies to encourage installation and uptake of information technologies and telecommunications, including infrastructure upgrading and plans for 'full informatisation in government'.⁵

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- 2 Booz-Allen and Hamilton, *Scoping of Issues for the Panel Debate*, 21 March 1997, Discussion paper for 'G7 Global Marketplace for SMEs' Conference, [www.ispo.cec.be/Ecommerce/doc2.html] Part III; Ministerial Declaration from 'Global Information Networks' Ministerial Conference, Bonn 6-8 July 1997, Points 1, 10 and 18.
 - 3 www.consult.
 - 4 Booz-Allen and Hamilton, *Scoping of Issues* paper, Parts III and IV.
 - 5 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, OECD Paris, 1997, pp. 73-4.

6.7 The Electronic Commerce Promotion Council (ECOM) was established to build on the existing strength of Japanese industry, and assist with 'developing the technological and social infrastructures necessary to promote Electronic Commerce'.⁶

6.8 In May 1997 the Japanese Government released two discussion papers, *Towards the Age of the Digital Economy*, and, *Providing Support for Small and Medium Size Enterprises*.⁷ The latter identified reasons why Japanese SMEs were falling behind in the uptake of electronic commerce, and stated the government's intended policy response. Through 'standardisation of business models, nurture of human resources, and promotion of model businesses in the local regions', an environment would be created which enabled SMEs 'to introduce electronic commerce easily'.⁸

United States

6.9 As outlined in *A Framework for Global Electronic Commerce*, US policy opposes direct government involvement in internet commerce development, except for establishing an environment in which private enterprise can flourish.

6.10 The *Framework* paper does not refer to SMEs. Nor does it recommend assistance for businesses to recognise or develop electronic markets, or undertake other business practices on-line. The US is, however, involved with the G7 *Global Marketplace for SMEs* project.

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- 6 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 74.
 - 7 Ministry of International Trade and Industry (MITI) Japan, *Towards the Age of the Digital Economy*, and hyperlink to *Providing Support for Small and Medium Size Enterprises (SMEs)*, [www.miti.go.jp/intro-e/a22801e.html].
 - 8 MITI, *Providing Support for Small and Medium Size Enterprises*, hyperlink from [www.miti.go.jp/intro-e/a22801e.html].

6.11 The US Government is supporting the development of more sophisticated information infrastructure. In February 1998, President Clinton indicated that the US Budget would include 'US\$110 million to develop the next generation internet in partnerships with leading US high-tech companies and universities'.⁹

6.12 In its joint statement with the European Union on electronic commerce, the US government agreed that 'it is important to enhance the awareness and confidence of citizens and SMEs in electronic commerce and to support the development of related skills and network literacy'.¹⁰

European Union

6.13 The European Union (EU) is encouraging business, including SMEs, to increase their electronic commerce involvement. EU initiatives include:

- ESPRIT, an Information Technology research and development program, plus other R&D work;
- Euro-Info Centres network initiatives to increase exposure to electronic commerce techniques;
- Using and encouraging national governments to use electronic methods for procurement, administration and service provision; and
- Other awareness-raising, development support and best practice pilot project measures.¹¹

6.14 The G7's Bonn conference discussion paper identified contrasting business attitudes to electronic commerce in Europe and the US. The paper suggested that among 'less technology-friendly' Europeans, a 'fear of failure

9 Clinton Administration, *Remarks by the President to Technology 98 Conference*, 26 February 1998. Search via 'Whitehouse Documents' [www.whitehouse.gov/WH/html/library.html].

10 *Joint EU-US Statement on electronic commerce*, 5 December 1997, [www.qlinks.net/comdocs.eu-us.htm].

11 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 73; European Commission, *A European Initiative in Electronic Commerce*, paragraphs 65-70.

often prevents flexibility and entrepreneurship'. In the US on the other hand, 'the "Let's do it" attitude and the readiness to take some risks makes the market advance much faster'.¹²

6.15 This difference, it seems, helps account for the higher level of government involvement in Europe compared with the US. The European Union is encouraging European governments and businesses to take up internet commerce, while in the US that is unnecessary because of the already extensive private enterprise activities.

6.16 As worldwide commercial use of the internet increases, so does the role of languages other than English. In early 1997 it was predicted that by the end of that year, only 40% of European web pages would be posted in English, and further estimated that '75% of European businessmen do not speak English'. Catering to such a customer base, search engines like Alta Vista and Yahoo are now available in several languages. Furthermore, the initial drawbacks of European linguistic diversity have the potential to be advantageous, and it has been argued that '...the vast untapped populations of French (200 million worldwide) and Spanish speaking individuals means that the most popular sites in the future will be multi-lingual'.¹³

Other Countries

6.17 According to the Sacher Report, governments can use a combination of 'Facilitation' and 'Direct Promotion' of electronic commerce, depending on the level of private sector leadership already in place. Where there is little existing development, governments can 'act as important catalysts for the diffusion of electronic commerce applications in the private sector'.¹⁴

6.18 The Sacher Report identified India and Singapore as countries which have introduced significant measures to promote electronic commerce. Singapore for example has

12 Booz-Allen & Hamilton, *Scoping of Issues* paper, Part IV.

13 Urquhart, I., *Language Engineering and Electronic Commerce*, The Race for Multilinguality and Threats and Opportunities sections, [www2.echo.lu/langeng/en/repsecom/ecom.html].

14 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, pp. 65-66.

undertaken a national policy initiative designed to give it a 'head start' on its trading partners in provision of infrastructure and restructuring of business processes.¹⁵ Innovations include a government-wide electronic procurement system, introduction of stored value 'cash-cards', and the launch of an Electronic Commerce Hotbed to pilot relevant applications.¹⁶

6.19 Malaysia is also investing heavily in government internet projects. These focus mainly on large corporations, but are also providing incentives for small firms to list on the new information technology stock exchange.¹⁷ Canada has less government involvement, but has introduced incentives for SMEs to take up electronic methods. For example, SMEs receive 'almost immediate' payment with electronic procurement, and for rebates from electronic tax returns.¹⁸

G7: 'Global Marketplace for SMEs'

6.20 The G7 Pilot Project, *A Global Marketplace for SMEs*, aims to facilitate increased competitiveness and participation in global trade for SMEs. It provides a coherent operational framework and a plan of implementation for global coordination and cooperation in electronic commerce, focusing on SMEs.¹⁹

15 Sacher Report, *Electronic Commerce, Opportunities and Challenges for Government*, p. 66.

16 Department of Foreign Affairs and Trade, *Putting Australia on the New Silk Road*, Canberra 1997, pp. 29-30.

17 Department of Foreign Affairs and Trade, *Putting Australia on the New Silk Road*, p. 28.

18 Department of Foreign Affairs and Trade, *Putting Australia on the New Silk Road*, p. 27.

19 G7 Pilot Project: *Update on the project's achievements*, [www.ispo.cec.be/Ecommerce/g7achiev.htm].

6.21 The countries involved in the project include G7 nations, seven other European countries, the Central and Eastern European Countries (CEECs), Australia, Argentina, Egypt, Korea, Mexico, Singapore and the OECD.²⁰ The project is divided into three Themes:

- **Theme 1: A Global Information Network for SMEs** – aims to 'develop an open and non-discriminatory information network for SMEs', through which they can collect and disseminate information on the World Wide Web. Features a common entry point with links to Web pages from a dozen countries.²¹
- **Theme 2: Business Requirements of SMEs** – addresses common legal, institutional and technical issues, through a collection of Working Groups which aim to 'animate the discussion about and to stimulate initiatives in electronic commerce'.
- **Theme 3: International Testbeds for electronic commerce** – which 'address the business and user requirements and the systemic issues identified in Theme 2'. They validate proposed solutions, provide feedback on business requirements and barriers to the uptake of electronic commerce, and promote awareness using 'showcase' examples.²²

6.22 A best practice book has also been issued, to raise awareness and provide examples of how particular SMEs have dealt with challenging electronic commerce issues.²³

6.23 A discussion paper produced for the G7's first annual conference, held in Bonn in 1997, predicted that electronic commerce could facilitate a combination of 'the traditional strengths of SMEs (flexibility, entrepreneurship,

20 G7 Pilot Project: *Update on the project's achievements*, [www.ispo.cec.be/Ecommerce/g7achiev.htm].

21 The G7 entry point is at [www.gin.sme.ne.jp/homee.html].

22 G7 Pilot Project: *Update on the project's achievements*, [www.ispo.cec.be/Ecommerce/g7achiev.htm], Section 2.

23 G7 Pilot Project: *Update on the project's achievements*, [www.ispo.cec.be/Ecommerce/g7achiev.htm], Section 2.

private initiative and quick response) with those of large corporations (economies of scale, scope and global reach).²⁴ It summarised the recommended 'way forward' as:

- limit state and public authorities' involvement to the definition of a clear and consistent minimum framework;
- allow market forces and private entities to act, but encourage flexibility and innovation; and
- focus on 'jumpstarting' through education, mostly through SME associations and other third parties.²⁵

Australian SMEs

Opportunities and challenges

6.24 Some groups, in evidence to the inquiry, have promoted the benefits of internet commerce and encouraged SMEs to compete aggressively for market share. The Department of Foreign Affairs and Trade (DFAT) claims that there are significant opportunities for growth in international trade. It is suggested that as internet access increases and internet interfaces become more sophisticated, consumers will, for some goods and services, have a world market to choose from. This could create a more competitive environment for business. DFAT stated:

*If Australian SMEs do not become widely involved in electronic commerce when there is a business case for doing so, or if that involvement occurs more slowly than in our major trading partners, this could undermine our medium to long term international competitiveness and slow economic growth.*²⁶

24 Booz-Allen & Hamilton, *Scoping of Issues* paper, Part V.

25 Booz-Allen & Hamilton, *Scoping of Issues* paper, Part V.

26 Department of Foreign Affairs and Trade, *Putting Australia on the New Silk Road*, p. 2.

6.25 A similar scenario was suggested by the Western Australian Department of Commerce and Trade which identified new commercial opportunities but also increased levels of competition:

*The emergence of internet commerce is creating opportunities particularly for small and medium sized enterprises. New opportunities in international markets have the potential to significantly boost earnings and create new areas of employment. These same opportunities are also being examined by overseas businesses with a view to selling goods and services in the Australian market place. Ready or not, Australian enterprises are about to be swamped by overseas competition.*²⁷

6.26 The Department of Industry, Science and Tourism (DIST) commented that some existing market access problems could be reduced by internet commerce. DIST suggests that internet commerce will help to reduce or alleviate:

- physical distance from a number of major markets, such as the US or UK, which could avoid the need to set up regional operations;
- the costs associated with market research, advertising and training; and
- the effect of quotas, licensing of professionals, the protection of local culture and other non-tariff barriers designed to protect local industries.²⁸

27 Western Australian Department of Commerce and Trade, *Submission*, p. S104.

28 Department of Industry, Science and Tourism, *Submission*, p. S430.

Internet usage and awareness

6.27 One of the key issues for examination in this Chapter is internet usage and awareness by SMEs. Some of the evidence commented on the extent to which SMEs are using the internet to maximise their business objectives. DIST commented that 'many businesses, particularly SMEs, have been slow to come to grips with the opportunities and threats' associated with internet commerce.²⁹ DIST stated:

*It would seem that there is wide acceptance that there are significant benefits for business from the adoption of electronic commerce. However, business to date has been wary of adopting electronic commerce because of the uncertainty of returns on investments, and security and privacy concerns. Also, business is to some extent uninformed about the productivity improvements that become possible using these technologies and also of the emerging market for these products internationally.*³⁰

6.28 DFAT commented that while internet awareness levels amongst business are rising, there is still 'a long way to go' to improve awareness levels.³¹ Telstra advised that many corporate websites were only at the advertising or marketing stage with transactional services not commonly available.³²

6.29 Some SMEs reported on the strategies they are developing to take advantage of internet commerce. The Jewellers Association of Australia (JAA) indicated that as a first step, it has provided an individual website for every member at no charge.³³ The Australian Retailers Association (ARA) stated:

One of the challenges we also have as an association is to educate our members as to not only the threats but also the opportunities that electronic commerce opens up for them. The technology is becoming cheaper. Smaller and smaller

29 Department of Industry, Science and Tourism, *Submission*, p. S434.

30 Department of Industry, Science and Tourism, *Submission*, p. S448.

31 Mr Mike Adams, Department of Foreign Affairs and Trade, *Transcript*, 27 October 1997, p. 46.

32 Mr John Simon, Telstra, *Transcript*, 6 November 1997, p. 219.

33 Mr Chris Reeves, Jewellers Association of Australia, *Transcript*, 20 October 1997, p. 8.

*retailers are able to start accessing this and we are setting up mechanisms within our association to try to assist that process and ensure that, to the extent that there are opportunities for retailers, they are able to take advantage of it.*³⁴

6.30 The Australian and New Zealand Association of Antiquarian Booksellers (ANZAAB) advised that its members were using the internet as an effective marketing and sales tool. Ms Susan Tompkins, President of ANZAAB, stated:

*...it has just been a huge new market for us. Retail sales have been pretty grim in the last year, and it really has been a great fillip to that—and I think it will get bigger. The sorts of search engines they have across these databases will become more sophisticated. It is easy to access them and I think, as more book buyers get on the Internet, the level of sales will get larger.*³⁵

6.31 ANZAAB indicated that 20 of its 43 members have most of their stock listed on data bases in the US and in Australia. Orders have been received from every continent with the majority coming from the US. Ms Tompkins indicated that in her situation sales have increased by ten per cent through new orders received through the internet. Ms Tompkins indicated that the internet was creating new markets and not merely replacing existing markets. Ms Tompkins, stated:

*I have had a lot of orders from South America, which is somewhere I would obviously have no reason to get any customers from. There is a lot from America. People have had them from Namibia, Turkey and Iran—all over the place.*³⁶

34 Mr David Shetliffe, Australian Retailers Association, *Transcript*, 5 November 1997, p. 127.

35 Mrs Susan Tompkins, Australian New Zealand Association of Antiquarian Booksellers, *Transcript*, 6 November 1997, p. 260.

36 Mrs Susan Tompkins, Australian New Zealand Association of Antiquarian Booksellers, *Transcript*, 6 November 1997, p. 263.

Survey data on usage and awareness

6.32 According to *www.consult*, there are currently some 15 000 enterprises with a permanent connection to the internet³⁷, and some 54 800 enterprises with some form of web presence.³⁸ There are some 450 000 enterprise users with web access and approximately as many with email access to the internet in Australia, with internet use proportionally higher in larger enterprises and in very small businesses and the small home office environment.

6.33 The primary use of the website amongst enterprises is:

- product promotion and advertising 51%
- information dissemination and retrieval 18%
- fax replacement 9%
- corporate communications 5%
- electronic commerce 4%³⁹

6.34 The primary intention of the website functionality amongst enterprises with internet access but without a web presence is:

- product promotion and advertising 58%
- fax replacement 10%
- information dissemination and retrieval 12%
- electronic commerce 4%
- corporate communications 3%⁴⁰

6.35 The conclusions drawn by *www.consult* regarding enterprise use of the website include:

- enterprises are aware of the potential of electronic commerce but are being realistic given the number of internet users and the market demand for internet-based services;

37 *www.consult*, *IAP Report*, April 1998.

38 *www.consult*, *Web Hosting Report*, February 1998.

39 *www.consult*, *Enterprise Internet & Intranet Report 1997*.

40 *www.consult*, *Enterprise Internet & Intranet Report 1997*.

- small to medium-sized enterprises are not yet willing to commit significant funds or resources towards developing sophisticated web-based services because of the lack of demand, competitive need to do so and available budgets;
- enterprises are still sceptical about the potential returns from investments in electronic commerce, and at this point there is very little evidence that they are wrong, especially as many of *the first movers* have not gained sustained competitive advantage. However, there are some industries which have seen significant activity, such as technology product sales, online brokerage and retail banking; and
- larger enterprises have greater potential to achieve and sustain cost reductions and other benefits compared to smaller enterprises, although this does not exclude entrepreneurial activity.

6.36 When asked about the significance of the internet website to the business of the organisation, enterprises with both internet access and web presence concluded that it was basically too soon to tell, although many felt that the website was:

- very significant 13%
- significant 21%
- too soon to tell 36%
- little significance 19%
- not significant 4%⁴¹

6.37 At the same time, however, returns on the investment in the website were generally regarded as low:

- negative returns 10%
- no return 45%
- less than 10% return 14%
- between 10% and 30% return 13%
- between 30% and 50% return 3%
- more than 50% return 6%⁴²

41 *www.consult*, *Enterprise Internet & Intranet Report 1997*.

42 *www.consult*, *Enterprise Internet & Intranet Report 1997*.

The competitiveness of Australian SMEs

6.38 DFAT suggested that Australia's performance in electronic commerce is linked to various developmental stages of electronic commerce. In the initial stage, the US will dominate because of its more advanced internet environment and the superior web content provided by US companies.

6.39 In addition, DFAT claims that Australians spend 80 per cent of their online time visiting websites outside the country and source and pay for products and services mainly from US companies. During this stage of internet commerce, DFAT suggests that 'electronic commerce in Australia probably will be associated more with imports than exports, regardless of what is done to develop an enabling environment'.⁴³ The Australian Taxation Office made a similar finding commenting that 'the short term impact of electronic commerce may adversely impact some Australian businesses but this trend could be reversed in the longer term'.⁴⁴

6.40 As electronic commerce develops, it is suggested that Australian companies will become more competitive. One scenario suggested by DFAT is that Australian companies will establish partnerships or enter into franchise arrangements with successful overseas operators, and develop levels of sophistication equal to those found in the US. At that stage, DFAT is optimistic that trade performance would turn around as Australian consumers would have more reasons for purchasing goods and services from domestic websites.⁴⁵

6.41 DIST commented that while internet commerce will create more competition for SMEs, there are some positive signs. For example, DIST commented that 'Australia currently has a slight lead in the Asia Pacific region—a lead which Australian businesses should capitalise on swiftly'.⁴⁶

43 Department of Foreign Affairs and Trade, *Putting Australia on the New Silk Road*, p. 18.

44 Australian Taxation Office, *Tax and the Internet*, Finding 9, p. 84.

45 Department of Foreign Affairs and Trade, *Putting Australia on the New Silk Road*, p. 18.

46 Department of Industry, Science and Tourism, *Submission*, p. S433.

6.42 At the Committee's round table forum, participants were asked what were the key factors restricting the international competitiveness of Australia's SMEs. DFAT suggested the following:

- awareness problems, particularly in the manufacturing industries and some areas of retailing; and
- a perception in rural and regional Australia, in particular, that there were bandwidth problems for businesses wishing to use the internet.⁴⁷

6.43 www.consult also commented on factors affecting the competitiveness of Australian SMEs. It identified some key features of internet commerce which showed that the Australian experience was comparable to world standards. Some of the key observations were:

- **speed of networks** – 'we are in absolute terms faster than New Zealand, Singapore, and Malaysia';
- **internet costs** – 'we are basically not too badly off compared to the region, if you look at the cost performance and service support that we do get here. In terms of business costs, again, we are not too bad. We are, in fact, in reasonably good shape compared to Asia, especially digital connectivity. We are still much more expensive than the US, but that problem is consistent around the world';
- **security** – a big concern for enterprises that are involved with the web;
- **infrastructure** – 'no real issue here'.⁴⁸

6.44 www.consult testing of internet network speeds and availability in Australia, Singapore, Malaysia and New Zealand clearly demonstrates that internet access speeds from Australia to the United States are on average higher than from the other countries to the US.⁴⁹

47 Dr Mike Adams, Department of Foreign Affairs and Trade, *Transcript*, 3 February 1998, p. 588.

48 Mr Ramin Marzbani, www.consult, *Transcript*, 3 February 1998, pp. 590–592.

49 www.consult, *Probe Reports 1996–1998*, 47 000 tests per month.

6.45 www.consult analysis of internet access pricing for permanent connections in Australia compared with 11 countries in South East Asia demonstrates 'slightly lower' to 'lower' costs faced by Australian enterprises in gaining a permanent connection to the internet in most cases.⁵⁰ However, for the same cost of a 128 Kbps internet connection in Australia, \$1,500 to \$2,500 per month, an enterprise could get an internet connection with 10 times the capacity in most US cities. The implications of this price difference are widespread, ranging from lower unit productivity associated with using the internet in an enterprise to higher entry and operating costs for small to medium-sized enterprises.

6.46 Enterprise security concerns with the internet are very real. However, there are no absolute guarantees when it comes to security, and it is best regarded as a process rather than an outcome. When asked about the level of satisfaction with the security provisions for internet access within the organisation, most of the enterprises with internet access and a web presence were reasonably satisfied. However, some doubts remain:

| | |
|--|------------------|
| • very satisfied | 12% |
| • satisfied | 40% |
| • dissatisfied, but regard it as best effort | 32% |
| • dissatisfied | 5% |
| • very dissatisfied | 2% ⁵¹ |

6.47 Unfortunately, the costs associated with setting up a robust level of security, similar to many other components associated with internet use and electronic commerce, are relatively fixed. The implications of these fixed costs to SMEs is a higher unit cost, whether it is cost per employee or cost per transaction, when compared with larger enterprises.

6.48 The availability in Australia of more than 632 internet service providers (ISPs), 1 050 web developers, thousands of competing technology and solution providers and systems integrators, as well as a more competitive telecommunications infrastructure, positions Australia very well compared to most other countries in the region. Except

50 www.consult, *Asian ISP Report*, January 1998.

51 www.consult, *Enterprise Internet & Intranet Report 1997*.

for the fixed cost problem, which in some cases can be addressed by intermediaries and aggregators, SMEs will continue to face a higher unit cost compared with larger as well as very small enterprises.⁵²

Government activities

The regulatory environment

6.49 One of the key themes of some reports on internet commerce is that the private sector should lead. This was a key principle in the Clinton Administration's paper, *A Framework for Global Electronic Commerce*.⁵³ The Information Policy Advisory Council (IPAC) supported this principle, recommending that 'the Australian Government adopt a succinct, highly purposeful, but limited role in enabling Australia's participation in the global information economy'.⁵⁴

6.50 One of the key roles for government was to provide a coherent regulatory regime. The Western Australian Department of Commerce and Trade stated:

*To facilitate Australia's international competitiveness, the Federal Government should pursue a minimalist approach to regulation and a simple legal environment which does not impinge on internet commerce.*⁵⁵

6.51 Optus Communications commented that the regulatory framework for internet commerce needs to strike a balance between:

- onerous regulatory requirements which may result in ISPs and business operating in jurisdictions with less regulation; and

52 Ramin Marzbani, www.consult.

53 President Clinton, *A Framework for Global Electronic Commerce*, July 1997, p. 2.

54 The Information Policy Advisory Council, *A national policy framework for structural adjustment within the new Commonwealth of Information*, August 1997, p. 14.

55 Western Australian Department of Commerce and Trade, *Submission*, p. S104.

- the need for a regulatory framework which ensures security and authenticity for transactions over the internet.⁵⁶

6.52 The Internet Industry Association (IIA) also commented on the need to avoid regulatory barriers on industry development. In addition, the IIA suggested that there should be a 'sound, uniform national policy regime'.⁵⁷ The report by the Information Industries Taskforce, (the Goldsworthy Report), stated:

*Governments must adopt a non-regulatory, market-oriented approach to electronic commerce, one that facilitates the emergence of a transparent and predictable legal environment to support business and commerce.*⁵⁸

6.53 The Australian Government in its policy statement, *Investing for Growth*, identified the following legal and regulatory issues and indicated that it will:

- adopt the OECD guidelines on cryptography as the basis of policy;
- address taxation of electronic commerce;
- facilitate the establishment of a national system for the authentication of users in electronic commerce;
- develop under Office of Government Information Technology leadership a strategy to support government agencies in implementing public key technology for online transactions using public networks;
- pursue the broad direction of reforms recommended by the Financial System Inquiry on the regulation of the financial system and facilitation of electronic commerce;
- develop a framework to promote the privacy of personal data through the Privacy Commissioner;

56 Optus Communications, *Submission*, p. S264.

57 Internet Industry Association, *Submission*, p. S321.

58 The Information Industries Taskforce, *The Global Information Economy, The Way Ahead*, July 1997, p. 71.

- continue to be actively engaged in promoting and protecting consumer interests online, in conjunction with overseas regulatory bodies through the Australian Competition and Consumer Commission;
- protect intellectual property in the digital age, through development of proposals for reform of the existing legal framework in consultation with interested parties;
- implement a national self-regulatory framework for dealing with objectionable content; and
- review aspects of the legal framework for electronic commerce by an Expert Group reporting to the Attorney-General.⁵⁹

6.54 Part of the terms of reference for the inquiry includes reference to the current framework for intellectual property. While the internet provides a major distribution tool, sellers must be confident that their intellectual property is protected. At the same time, consumers must be confident that they are receiving authentic goods and services.

6.55 The Attorney-General's Department (AGs) commented on the current framework for intellectual property and its applicability in an internet environment. With regard to the Copyright Act, AGs commented that it 'provides limited protection for the use of certain kinds of copyright material on the internet'.⁶⁰

6.56 To address some of the concerns with the Copyright Act, AGs and DoCA, in July 1997, released the discussion paper *Copyright Reform and the Digital Agenda*. The paper 'sought comments on a proposed new package of rights to improve the protection of copyright in the new communications environment, including the internet'.⁶¹ The discussion paper proposed two new rights:

- a technology-neutral right of transmission to the public; and

59 The Howard Government's Plan for Australian Industry, *Investing for the Growth*, December 1997, p. 69.

60 Attorney-General's Department, *Submission*, p. S240.

61 Attorney-General's Department, *Submission*, p. S241.

- a separate right of 'making available' on-line to the public.

6.57 The discussion paper proposed a number of 'exceptions to these rights to ensure that the rights of copyright owners are balanced against the needs of users to have reasonable access to copyright materials'.⁶²

6.58 AGs advised that the copyright reforms proposed in the discussion paper would enable Australia to comply with obligations in the World Intellectual Property Organisation (WIPO) Copyright Treaty and the WIPO Performances and Phonograms Treaty. AGs stated:

*If implemented, the proposed changes in the Discussion Paper would pave the way for Australia to sign the new WIPO treaties and reform copyright law in this digital age. These proposals would improve the existing copyright protection for internet commerce.*⁶³

6.59 The US indicated that the two WIPO treaties, discussed above, 'will greatly facilitate the commercial applications of on-line digital communications over the global information infrastructure'.⁶⁴ In addition, the Clinton Administration stated in the *Framework for Global Electronic Commerce* that it is drafting legislation to implement the new WIPO treaties.

Government industry assistance

6.60 Evidence to the inquiry has touched on the issue of market failure and the need for government industry assistance. One of the themes that DFAT raises in the *New Silk Road* is for government to assist online Australian companies to operate successfully in export and international business, by increasing business awareness of electronic commerce and the opportunities it offers in international markets.⁶⁵ DFAT suggested that there was the need to provide

62 Attorney-General's Department, *Submission*, p. S242.

63 Attorney-General's Department, *Submission*, p. S242.

64 Clinton Administration, *A Framework for Electronic Commerce*, 1 July 1997, [www.iitf.nist.gov/elecomm/ecom.htm];

65 Department of Foreign Affairs and Trade, *Putting Australia on the New Silk Road*, p. xiv.

evidence from case studies 'which demonstrate the business case for internet commerce'.⁶⁶ The Western Australian Department of Commerce and Industry proposed that consideration should be given to allocating funds for:

- conducting national case studies which identify internet commerce initiatives and trade opportunities;
- providing companies with generic online export related services;
- providing specific assistance/advice to companies on internet business;
- developing overseas markets for Australian business penetration;
- promoting business capabilities in overseas markets;
- providing education and training schemes to improve Australia's skills base for the creation of sustainable information industries; and
- promoting skills development in information resource management in all vocational training programs.⁶⁷

6.61 DIST has 'a priority to accelerate the introduction of best practice on-line commerce/business systems and facilitate the broader reform of industries through the adoption of on-line technologies'.⁶⁸ The Information Technology Online Program, for example, is designed to accelerate the national uptake of on-line technologies, especially by small to medium sized enterprises.

66 Mr Mike Adams, Department of Foreign Affairs and Trade, *Transcript*, 27 October 1997, p. 47.

67 Western Australian Department of Commerce and Trade, *Submission*, p. S105.

68 Department of Industry, Science and Tourism, *Submission*, p. S434.

6.62 The Department of Communications and the Arts (DoCA) commented that the National Office for the Information Economy has received funding of \$3 million over two years 'to establish a national promotional campaign aimed at increasing awareness of the benefits and importance of being online'.⁶⁹

6.63 The effectiveness of industry assistance programs was raised by some groups in evidence to the inquiry. www.consult, for example, questioned the need for government involvement suggesting that market forces would work to ensure that deficit areas or inefficiencies would be eliminated. www.consult stated:

I think the responsibility is with the company at all times. I came this morning from some meeting at DFAT on the 'New silk road'. They were talking about the government putting money in for this and that. It is amazing. The government might as well come in and help me do my accounting. The government does not come and help me decide what sorts of products to design. The government has absolutely no role in this whatsoever.⁷⁰

6.64 The report by David Mortimer, *Going for Growth – Business Programs for Investment, Innovation and Export*, while not focusing on internet commerce, commented on the role and effectiveness of Government in assisting business to be innovative. The report stated:

The extent to which the Government can help business to be 'innovative' is limited. The development of management competencies and technical skills is essentially the responsibility of the individual business. However, because firms are generally unable to capture for themselves the full benefits associated with R&D there is a strong tendency to underinvest. Accordingly, virtually all governments intervene to directly support R&D activities in order to correct for private underinvestment and in recognition of the net public benefits created.⁷¹

69 Department of Communications and the Arts, *Submission*, p. S510.

70 Mr Ramin Marzbani, www.consult, *Transcript*, 15 December 1997, p. 427.

71 Review of Business Programs, *Going for Growth – Business Programs for Investment, Innovation and Export*, June 1997, p. 99.

Government service provision

6.65 The role of government in the information economy can be enhanced by using the internet to provide a range of government services. The Goldsworthy Report suggested that Government use of the internet will provide a valuable 'kick start' for internet commerce.⁷² IPAC proposed that the Government should 'deploy innovative online services'.⁷³ DoCA stated:

One of the more influential ways in which the Government can show leadership in the information economy is by itself taking the lead in the use of such services, to improve its own business practices, and to better deliver its services to all Australians. As a major user and customer, the Government can act as a significant catalyst for change, encouraging uptake of information technology and online services by businesses and citizens.⁷⁴

6.66 The Australian Government in its policy statement, *Investing for Growth*, made the following undertakings regarding the provision of online government services:

- delivering all appropriate Commonwealth services electronically on the internet by 2001. This will complement – not replace – existing written, telephone, fax and counter services;
- establishing a Government Information Centre through OGIT as a single point of access to information about government service, with the first stage to be complemented by the third quarter of 1998; and
- establishing electronic payment as the normal means for Commonwealth payments by the year 2000.⁷⁵

72 The Information Industries Taskforce, *The Global Information Economy, The Way Ahead*, July 1997, p. 67.

73 The Information Policy Advisory Council, *A national policy framework for structural adjustment within the new Commonwealth of Information*, August 1997, p. 13.

74 Department of Communications and the Arts, *Submission*, p. S517.

75 The Howard Government's Plan for Australian Industry, *Investing for the Growth*, December 1997, p. 70.

6.67 The Australian Government's internet entry point is located at [www.fed.gov.au]. From this point, a range of government agencies can be accessed. Agency websites provide general information about the role of the agency, services provided and, in some cases, the opportunity to download publications. Parliamentary Hansard reports, Australian legislation and High Court judgements are available for download. Members of the public can use email to communicate with most government agencies. More interactive services in which members of the public can send and receive information relating to service provision will steadily become available. The following agencies, in evidence to the inquiry, described some of the services that are, or soon will be, provided over the internet:

- **AUSTRADE:** World Direct provides a focal point for Australian business to obtain information on exporting and gives Australian businesses listed on the site exposure to the online business world⁷⁶ [www.austrade.gov.au]. The United Nations provides an internet service to facilitate trade. Information can be found at the United Nations Trade Point Development Centre [www.unicc.org/untpdc/welcome.html];
- **Australian Bureau of Statistics:** The internet will provide another way to access official statistics. It may also be possible for businesses as data providers to use internet processes to interact more effectively with the ABS⁷⁷ [www.abs.gov.au];
- **Australian Customs Service:** With the establishment of the Secure Gateway Environment (via DPIE), the internet can now be used as an alternative means of reporting the regulatory information required by Customs⁷⁸ [www.customs.gov.au];

76 AUSTRADE, *Submission*, p. S559.

77 Australian Bureau of Statistics, *Submission*, p. S179.

78 Australian Customs Service, *Submission*, p. S156.

- **Australian Taxation Office:** The ATO indicated that it should take advantage of low cost internet technologies, and implement an internet based system similar to the Electronic Lodgement System, which need not involve direct communication with the ATO's production mainframe computers⁷⁹;
- **Department of Finance and Administration:** Transigo will allow Australian suppliers to develop an electronic commerce capability, and use electronic commerce services to trade electronically with overseas markets. Suppliers will be able to identify overseas business opportunities and transact business electronically using technologies like e-mail, electronic forms and Electronic Data Interchange [www.dofa.gov.au];
- **Department of Primary Industries and Energy:** PIENet is a comprehensive collection of Australian and international information resources on the subjects of agriculture, economic research, minerals and energy, environment, fisheries, forestry, geoscience, and quarantine⁸⁰ [www.dpie.gov.au]; and
- **Department of Workplace Relations and Small Business:** The Business Entry Point will provide access to government information and provide a single process for the registration requirements of Treasury agencies [www.bisentry.gov.au].

Conclusions

6.68 One of the key themes of the inquiry is the need to recognise the potential commercial opportunities created by internet communications. Linked with this is the need for Australian industry to use modern communication technologies as part of their business plan and take full advantage of the new domestic and international commercial opportunities offered by internet commerce.

79 The Australian Taxation Office, *Tax and the Internet*, AGPS, Canberra, 1997, p. 103.

80 Department of Primary Industries and Energy, *Submission*, p. S253.

6.69 The Committee's examination of internet commerce and the awareness and performance of Australian SMEs is only preliminary. The market is immature and information relating to SME performance is not definitive. At this stage, it is essential that market mechanisms not be restricted by inappropriate government regulation. One of the key requirements for business is a regulatory framework which encourages growth and economic efficiency. Business and consumers are calling for a regulatory framework which provides fairness and confidence. Some of the key regulatory issues include:

- security and privacy;
- consumer protection;
- identification and authentication;
- taxation; and
- intellectual property and copyright.

6.70 The Committee has made specific comments on some of these issues in other parts of the report. Overall, the Committee encourages the Government to achieve outcomes that are timely, effective and consistent with the best international standards.

6.71 Some government agencies advised the Committee that they are seeking to raise SMEs' awareness of the threats and opportunities of internet commerce. In contrast, some groups insist that levels of awareness and participation will increase as the market develops and, therefore, government participation is unnecessary. The Committee does not agree with this.

6.72 There is a case for government to be involved in promoting and raising awareness of the challenges and opportunities of internet commerce. In taking this course, the Australian Government must compare its performance with other countries. The US Government, for example, is not a silent observer to market forces. The President is proactive in communicating the benefits of internet commerce. At the same time, the US Government is heavily subsidising the development of INTERNET 2 to the tune of US\$110 million in 1998.

6.73 The Committee concludes that there is the need for a detailed examination into the awareness and competitiveness of Australian industry in the internet commerce environment. The Committee acknowledges that the market is immature and research may be hindered by

data problems. Notwithstanding this, the Committee recommends that the Industry Commission conduct a multi-industry inquiry focusing on, but not limited to, structural changes in the economy, development and growth issues for industry, and regulatory requirements arising from the growth in internet commerce.

6.74 A further issue that the Committee examined is the provision of government services through the internet. The Government is a major user and supplier of services, and use of the internet to conduct these activities may encourage the uptake of information technology.

6.75 The Committee encourages all government agencies to provide services, where appropriate, online. Agencies will need to ensure that their systems provide security and privacy. In addition, agencies will need to ensure that access and equity are not compromised.

6.76 Agencies must ensure that their systems are efficient and effective. This task should be assessed by the Auditor-General. The Committee therefore recommends that the Auditor-General conduct a multi-agency performance audit of the efficiency and effectiveness of government service provision through the internet. As part of the audit, the Auditor-General should examine measures to provide security and privacy, and comment on agencies' strategies for ensuring access and equity. The Auditor-General should conduct this inquiry during 1999.

6.77 Recommendation 15

The Industry Commission should conduct a multi-industry inquiry focusing on, but not limited to, structural changes in the economy, development and growth issues for industry, and regulatory requirements arising from the growth in internet commerce.

6.78 Recommendation 16

The Auditor-General should conduct a multi-agency performance audit, during 1999, of the efficiency and effectiveness of government service provision through the internet, taking account of, but not limited to:

- (a) the effectiveness of measures to provide security and privacy; and*
- (b) strategies for ensuring access and equity.*

7**CONSUMER PROTECTION AND
PRIVACY ISSUES****Introduction**

7.1 Consumer protection and privacy issues influence a range of matters being considered in the inquiry. For internet commerce to grow, consumers must have a sufficient level of confidence about payment and security systems as well as knowing that privacy standards are adequate. These are threshold requirements for the successful growth and conduct of internet commerce. Business has an incentive to ensure that the trading environment matches consumer needs and expectations.

7.2 During the Committee's round table forum, participants identified security, privacy, identification and authentication as key issues requiring further development. This Chapter will examine progress on these matters.

7.3 A key objective for this Chapter is to comment on the appropriateness of Australia's proposed self-regulatory privacy regime for the private sector. Some groups argue that a legislated privacy scheme will be more effective. In addition, these groups argue that Australian legislation is needed to satisfy European Union standards.

**Factors affecting consumer and
business participation**

7.4 For consumers and business, issues relating to security, privacy and authentication are some of the most important issues determining whether they become involved in internet commerce. Surveys repeatedly show that these issues are high amongst the list of major concerns. The

Australian Consumers Association (ACA) advised that a recent survey of American consumers showed that in the US, privacy was the number one concern.¹

7.5 Australian survey data shows slightly different responses based on whether respondents are consumers or businesses. For consumers, the major concerns vary by experience levels. For all consumers, the major concerns are:

| | |
|--------------------------------------|-----------------|
| • response time | 22% |
| • access cost | 21% |
| • security of financial transactions | 17% |
| • privacy | 13% |
| • no concerns | 9% ² |

7.6 Internet users with more than 2 years of online experience cited their concerns as:

| | |
|--------------------------------------|------------------|
| • response time | 25% |
| • access cost | 22% |
| • security of financial transactions | 13% |
| • privacy | 10% |
| • no concerns | 10% ³ |

7.7 Internet users with less than 6 months of online experience cited their concerns as:

| | |
|--------------------------------------|-----------------|
| • access cost | 21% |
| • security of financial transactions | 20% |
| • privacy | 16% |
| • response time | 16% |
| • no concerns | 8% ⁴ |

7.8 For businesses, the major concerns also vary by experience levels. For all businesses with an established internet access and web presence, the major concerns are:

| | |
|-----------------------------|-----|
| • security | 30% |
| • obtaining value for money | 14% |
| • productivity loss | 12% |

1 Ms Mara Bun, Australian Consumers Association, *Transcript*, 3 February 1998, p. 602.

2 Mr Ramin Marzbani, *www.consult*, *Transcript*, 3 February 1998, p. 602.

3 *www.consult*, *New Wave Internet User Report*, April 1998.

4 *www.consult*, *New Wave Internet User Report*, April 1998.

| | |
|-------------------|-----------------|
| • cost escalation | 11% |
| • response time | 11% |
| • privacy | 9% ⁵ |

7.9 Businesses without Internet access or presence cited their concerns as:

| | |
|---------------------|-----------------|
| • value for money | 26% |
| • security | 24% |
| • cost | 15% |
| • privacy | 11% |
| • productivity loss | 6% ⁶ |

7.10 Privacy is an issue recognised and identified by both consumer and business users of internet technology. At the business level, the safeguarding of employee privacy is likely to conflict with the need to monitor use of business resources in a manner similar to the phone and fax. In addition, legal issues such as management of inappropriate material or harassment at work are also likely to conflict in some degree with the protection of privacy of employees.

7.11 At the consumer level, it is likely that consumers will be given the options to provide personal and private data in return for inducements by advertisers and marketers, who would in turn aggregate and use or resell this information. With the rapid rate of technology change, it could be difficult to provide effective safeguards or complaint resolution procedures, especially as many of the aggregators of personal information are likely to operate outside of the legal jurisdiction of Australia.

7.12 The potential for unauthorised access to private information by third parties through the internet is significant and it is currently unlikely that such access can be completely stopped. It is also impractical for businesses to completely stop breaches of security, from within the business or from the internet.

5 *www.consult*, *1997 Enterprise Internet and Intranet Survey*.

6 *www.consult*, *1997 Enterprise Internet and Intranet Survey*.

Consumer protection

7.13 One of the inhibiting factors claimed to affect the rate of internet commerce is the low level of consumer confidence. The internet is an 'open' system and was never designed with security as a priority. There is evidence suggesting that consumers are reluctant to purchase goods and services over the internet because of concerns with payment systems and consumer protection issues such as redress and compensation, and the reliability of retailers.⁷

7.14 With the rise of internet trading, consumers have been concerned at the potential for sensitive financial information, such as credit card numbers, to be intercepted if they are sent across the internet. The Federal Bureau of Consumer Affairs (FBCA) suggested a range of factors which will influence the extent to which new payment systems meet the needs of consumers. These factors include:

- the level of information provided to consumers about payment systems;
- the ability to support electronic commerce, for example through assisting with consumer protection and choice of vendors;
- liability for losses and dispute resolution;
- provision of transaction information to consumers;
- data collection and privacy;
- costs to the consumer; and
- security.⁸

7.15 International internet transactions create the most significant consumer protection issues. Under Australia's *Trade Practices Act 1974*, certain business practices are made illegal in order to protect consumers. For example, some of the provisions:

7 Federal Bureau of Consumer Affairs, *Untangling the Web, Electronic Commerce and the Consumer*, AGPS, Canberra, March 1997, p. 2.

8 Federal Bureau of Consumer Affairs, *Untangling the Web, Electronic Commerce and the Consumer*, pp. v-vi.

- prohibit misleading or deceptive conduct;
- establish a system of safety standards for goods and ban the sale of goods which do not meet safety standards; and
- prohibit a variety of other unfair business practices such as bait advertising, accepting payment without intending to supply goods or services, pyramid selling or demanding payment for unsolicited goods or services.⁹

7.16 These consumer protection provisions are likely to cease to apply and thus offer no protection in cases where consumers purchase goods from overseas.¹⁰ The Department of Industry, Science and Tourism (DIST) states:

While there are clear economic benefits in the legislative framework provided by the Trade Practices Act in relation to conventional forms of commerce, a similar regulatory-based approach is impractical for the online marketplace given its global coverage and the potential speed of online transactions. Some traditional legal remedies may still apply in the global online marketplace. For example, depending on the country where the supplier is located, other comparable laws may apply to the transaction. However, questions of what law may actually apply can be complicated, impractical and expensive.¹¹

7.17 The jurisdiction in which the supplier is located may have consumer protection laws but the process for an Australian consumer to activate these laws may be complicated and costly. The Australian Competition and Consumer Commission (ACCC) states:

Unfortunately, difficulties with enforcing protection legislation in the global marketplace means that the current regulatory framework for internet commerce may not be

9 Federal Bureau of Consumer Affairs, *Untangling the Web, Electronic Commerce and the Consumer*, p. 21.

10 Federal Bureau of Consumer Affairs, *Untangling the Web, Electronic Commerce and the Consumer*, p. 21.

11 Department of Industry, Science and Tourism, *Submission*, p. S667.

*sufficient to give consumers the degree of confidence they need to accept the internet as a safe means of commerce.*¹²

7.18 The ACCC suggested a range of alternative consumer protection strategies to improve consumer confidence and promote internet commerce. First is the need for coordinated law enforcement and compliance strategies. International cooperation by law enforcement agencies could help to improve the internet commerce environment. The ACCC, together with similar law enforcement agencies in other countries, recently conducted an 'international internet sweep day' whereby enforcement agencies surf the internet for scams, such as get-rich-quick schemes and inform the operators of those websites about the existence of consumer protection legislation in participating countries.¹³

7.19 In addition, the ACCC suggests that industry based solutions will be 'an important element of any overall solution to the consumer protection problems associated with internet commerce' and 'should involve industry associations and their members seeking appropriate remedies rather than waiting for a regulatory response from government'.¹⁴ Similarly, DIST commented that 'In the absence of the practical option of a traditional regulatory regime to operate in the global marketplace, there is an important need to develop a new policy framework which may deliver many of the levels of protection consumers traditionally expect'.¹⁵

7.20 The application of consumer protection laws applying to domestic transactions is more certain but some complications remain. This is because there is the potential for growth in interstate trade which may require the application of different state and territory laws. The FBCA warns that transactions across state and territory borders 'may require additional coordination between Australia's fair trading agencies'.¹⁶

12 Australian Competition and Consumer Commission, *Submission*, p. S288.

13 Australian Competition and Consumer Commission, *Submission*, p. S289.

14 Australian Competition and Consumer Commission, *Submission*, p. S290.

15 Department of Industry, Science and Tourism, *Submission*, p. S668.

16 Federal Bureau of Consumer Affairs, *Untangling the Web, Electronic Commerce and the Consumer*, p. vi.

7.21 In October 1997, the Minister for Customs and Consumer Affairs, the Hon Warren Truss, MP, released the report, *Consumer Protection in Electronic Commerce, Draft Principles and Key Issues*. The report was prepared by the National Advisory Council on Consumer Affairs (NACCA). The twelve draft principles include:

- **protection** – consumers using electronic commerce are entitled to the same protection as provided by the laws and practices that apply to existing forms of commerce.
- **identification** – consumers must be able to clearly establish the identity and location of businesses they deal with.
- **information** – consumers must be provided with clear and comprehensive information before and after any purchase of goods and/or services.
- **clarity** – sellers must state contract terms in clear simple language.
- **confirmation** – sellers should ensure they receive confirmed consent from consumers for a purchase of goods and/or services.
- **payment** – consumers are entitled to receive clear information about the types of payments which will be received.
- **complaints procedure** – consumers are entitled to have their complaints and enquiries dealt with fairly and effectively.
- **dispute resolution** – sellers should provide information to consumers about affordable and effective dispute resolution arrangements, where they are available.
- **privacy** – sellers must respect consumer privacy.
- **code compliance** – industry code administration bodies must closely monitor the application and effectiveness and be able to correct any deficiencies which are identified.

- **confidence** – each code operating body should strive to maintain and promote consumer confidence in the global marketplace.
- **regulation** – governments should actively develop their consumer protection responsibilities.¹⁷

7.22 NACCA suggested that the draft principles 'be used to prompt co-operative arrangements internationally'.¹⁸

Privacy issues

Internet privacy concerns

7.23 With some online payment systems there is particular concern that personal data can be tracked and stored more easily than with other forms of commerce. Electronic records may 'identify the individual making the payment, the items bought, the date and time of the transaction, the location of the vendor and the amount and type of payment made'.¹⁹

7.24 The Privacy Commissioner advised that 'detailed information can be collected without the knowledge or consent of the individual concerned'.²⁰ This information can be used to build a consumer profile showing individual spending habits,

17 National Advisory Council on Consumer Affairs, *Consumer Protection in Electronic Commerce, Draft Principles and Key Issues*, Canberra, 1997.

18 National Advisory Council on Consumer Affairs, *Consumer Protection in Electronic Commerce*, p. i.

19 Office of the Privacy Commissioner, *Submission*, p. S339.

20 Office of the Privacy Commissioner, *Submission*, p. S339.

financial status, movements, and tastes and preferences. Computer programs called 'cookies' help third parties to covertly monitor and collect this type of information. The Privacy Commissioner states:

*The personal information collected has a commercial value, not only to the collector but possibly to others who may wish to use it. Whenever information has been aggregated and centralised, there will always be pressure for it to be used for purposes other than for which it was collected.*²¹

7.25 A further feature of electronic payment systems is the decline in anonymity. Whereas cash payment is anonymous, electronic payment systems can maintain records of payments.

Encryption and security issues

7.26 The prime solution for providing security of transaction details and protecting privacy is the use of encryption technology. The Attorney-General's Department advised that it chairs the OECD Committee on Security, Privacy and Intellectual Property Protection in the Global Information Infrastructure and an ad hoc Expert Group on Cryptography Policy. The Expert Group was responsible for preparing the Cryptography Policy Guidelines released by the OECD in March 1997.²² The guidelines state:

- that the users of information technology must have trust in the security of information and communications infrastructures, networks and systems; in the confidentiality, integrity, and availability of data on them; and in the ability to prove the origin and receipt of data;

21 Office of the Privacy Commissioner, *Submission*, p. S339.

22 Attorney-General's Department, *Submission*, p. S231, [www.oecd.org/dsti/iccp/crypto_e.html].

- that, as cryptography can be an effective tool for the secure use of information technology by ensuring confidentiality, integrity and availability of data and by providing authentication and non-repudiation mechanisms for that data, it is an important component of secure information and communications networks and systems; and
- that the failure to utilise cryptographic methods can adversely affect the protection of privacy, intellectual property, business and financial information, public safety and national security and the operation of electronic commerce because data and communications may be inadequately protected from unauthorised access, alteration, and improper use, and, therefore, users may not trust information and communications systems, networks and infrastructure.²³

7.27 The market is working to provide reliable and secure systems. For example, Visa and Mastercard are introducing the Secure Electronic Transaction (SET) protocol for securing payments over open networks such as the internet. SET incorporates digital certificates, public key encryption and digital signatures.

7.28 Public key encryption, also called asymmetric encryption, uses two keys, one public and the other private. If a person sends confidential information to someone, the information can be encrypted using the recipient's public key. It can only be opened by the recipient who has the corresponding private key. In some ways, it is considered safer than symmetric key cryptography in which there is only one key. In this case, the sender would encrypt a document with a key that would need to be known by, or transmitted to, the receiver. If the key was transmitted, it could, for example, be intercepted.

7.29 Often, it will not be possible to determine or verify who has sent a message. Authentication systems attempt to achieve this. For example, in the physical world, a recognised signature or letterhead help to achieve authentication of the

23 OECD, *Cryptography Policy Guidelines*, March 1997.

sender. Similarly, a digital signature helps to achieve authentication and identity of the sender. A trusted certification authority confirms a user's identity and then can issue a public private key pair and a digital signature.

7.30 The Report of the Electronic Commerce Expert Group to the Attorney-General (the Expert Group) examined the legislative implications of the electronic signature regime. The Expert Group commented that a 'detailed legislative regime for electronic signatures needs to be considered with caution'.²⁴ The Expert Group pointed out that there is no international uniform legislative approach, and legislative approaches may not have due regard for market-oriented solutions. The Expert Group, therefore, recommended that 'legislation should deal simply with the legal effect of electronic signatures'.²⁵ The Expert Group commented that article 7 of the UNCITRAL Model Law on Electronic Commerce 'provides an appropriate model for Australia to address the threshold issue of legal recognition of electronic signatures'.²⁶

7.31 The ability of individuals to use powerful encryption systems to protect personal privacy may, however, be in conflict with community needs. For example, the community expects adequate and effective law enforcement, national security and the requirement that individuals and organisations pay the appropriate amount of taxation. With regard to law enforcement issues, the Attorney-General's Department stated:

...it is important to ensure that law enforcement's current capabilities to access stored data and intercept communications (provided, of course, that the relevant

24 Report of the Electronic Commerce Expert Group to the Attorney-General, *Electronic Commerce: Building the Legal Framework*, Canberra, March 1998, p. ii.

25 *Electronic Commerce: Building the Legal Framework*, p. ii.

26 *Electronic Commerce: Building the Legal Framework*, p. 136; The United Nations Commission on International Trade Law (UNCITRAL) completed work on the development of the Model law on Electronic Commerce in 1996, [www.un.or.at/uncitral/texts/electcom/ml-ec.htm].

*supervising authority sees fit to issue a warrant) is not compromised by encryption technologies which are designed to provide very high levels of confidentiality.*²⁷

7.32 The Australian Taxation Office (ATO) discussed encryption technology as a means of providing privacy and security. The ATO commented that 'attempts to prohibit encryption in a tax context are unlikely to be successful'. In addition, the ATO agreed with a conclusion by the Commonwealth Scientific and Industrial Research Organisation (CSIRO) that the successful development of the internet is dependent on achieving security. CSIRO commented that 'cryptography appears to be the only possible way to achieve security'.²⁸

7.33 The Privacy Commissioner discussed the 'key escrow' system in which government agencies would have access to encryption keys provided by trusted third parties which issue encryption keys. The Privacy Commissioner reports that this approach has drawn strong criticism from business, privacy advocates and 'more recently the European Union'.²⁹

7.34 The ATO, in Finding 25 of *Tax and the Internet*, commented that 'the introduction of 'key escrow' legislation is not recommended'.³⁰ The ATO, however, did comment that it would be desirable if it had 'limited and lawful access' to records and logs kept by trusted third parties 'under our existing access and information gathering powers, to combat money laundering and tax evasion'.³¹ The ATO acknowledges, however, that trusted third parties could operate in a tax haven.³²

7.35 The degree and level to which the ATO needs to have access to personal data has been questioned by the Privacy Commissioner. In particular, the Privacy Commissioner has drawn attention to recommendations 19

27 Attorney-General's Department, *Submission*, p. S231.

28 Australian Taxation Office, *Tax and the Internet*, Volume 1, AGPS, Canberra, 1997, p. 40.

29 Office of the Privacy Commissioner, *Submission*, p. S340.

30 Australian Taxation Office, *Tax and the Internet*, p. 92.

31 Australian Taxation Office, *Tax and the Internet*, p. 69.

32 Australian Taxation Office, *Tax and the Internet*, p. 69.

and 24 in the ATO's report, *Tax and the Internet*. In recommendation 19, the ATO is seeking support from 'major international credit card and electronic payment system providers to allow revenue authorities to obtain access to credit card transaction details held by credit card companies outside of the jurisdiction of the domestic revenue authority'.³³ The ATO argues that, under existing law, it has the right to examine this information where the records are held in Australia.

7.36 Recommendation 24 is concerned with electronic cash systems and reloadable card systems. The ATO is proposing that there be effective identification provisions for electronic cash systems. The ATO advised that it is entering into discussions with the Privacy Commissioner about these matters and will advise the JCPAA of the outcome of discussions.

Evidence supporting a legislated privacy regime

7.37 One of the major privacy issues raised in the inquiry is the type of privacy regime that will offer the greatest benefits for consumers and business. The contest is between a voluntary self-regulatory privacy regime and a legislated privacy regime. In March 1997, the Federal Government indicated its preference for a voluntary self-regulatory privacy regime and instructed the Privacy Commissioner to assist the private sector in developing such a code. The Government rejected a legislated privacy regime because compliance costs for business could be excessive.³⁴

7.38 On 20 February 1998, the Privacy Commissioner released *National Principles for the Fair Handling of Personal Information*. The principles are the first stage in the development of a national privacy scheme for Australia. The Privacy Commissioner commented that the principles 'are a workable compromise that would, if properly implemented,

33 Australian Taxation Office, *Tax and the Internet*, Recommendation 19, p. 118.

34 Office of the Privacy Commissioner, *Submission*, p. S343.

protect people's privacy with minimal red tape'.³⁵ The principles come under the following headings:

- collection
- use and disclosure
- data quality
- data security
- openness
- access and correction
- identifiers
- anonymity
- transborder data flows
- sensitive information³⁶

7.39 Within Australia, some business and advocacy groups have indicated their opposition to a self-regulatory privacy regime. In 1997, Price Waterhouse conducted a survey into the privacy practices of Australian business. Australia's top 400 companies were surveyed with responses received from 130. Respondents were asked if they supported the introduction of privacy legislation in light of the Federal Government's preference for a self-regulatory regime. The survey revealed wide support for the introduction of legislation with 60 per cent of respondents indicating 'support' and a further ten per cent indicating 'strong support'.³⁷

7.40 The Price Waterhouse survey also asked about the introduction of privacy codes of practice, and the cost to comply with legislation. Of the respondents, 62 per cent indicated that they were willing to participate in the development of codes of practice. With respect to the cost of compliance, there was the view that complying with legislation would not be a costly exercise with 62 per cent indicating that costs would be less than \$100 000. Price Waterhouse stated:

One of the most imposing statistics that we found is the overwhelming support for the introduction of privacy legislation with endorsement by 70% of respondents. This is

35 Human Rights and Equal Opportunity Commission, *Media Release*, 20 February 1998, [www.hreoc.gov.au/pubaffar/natprinc/htm].

36 Human Rights and Equal Opportunity, *National Principles for the Fair Handling of Personal Information*, February 1998, [www.hreoc.gov.au/privacy/natprinc.htm].

37 Price Waterhouse, *Privacy Survey 1997*, Melbourne, p. 8.

*in contrast to the Government view that legislation would add unnecessary burden and overhead to Australian business. Of the organisations surveyed, it was found that 79% felt only minor changes would be required to their business practices in order to comply with legislation, highlighting the fact that Australian business does not believe there will be significant costs associated with applying good privacy practice.*³⁸

7.41 Part of the concern about a self-regulatory privacy regime is the suggestion that countries with legislated privacy regimes may discriminate against Australia. The Australian Privacy Charter Council (APCC) indicated a range of countries including New Zealand, Hong Kong, Taiwan, South Korea and the European Union (EU) have or are moving to introduce privacy laws to regulate the private sector.

7.42 The APCC claims that EU countries will have consistent laws that will include provisions which will restrict the transfer of personal data to third countries without adequate privacy protection.³⁹ The APCC advised that Malaysia and Singapore 'are known to be preparing legislation to ensure that they are not disadvantaged by the EU initiative'.⁴⁰ The National Australia Bank (NAB) stated:

*We see New Zealand, Singapore and Hong Kong establishing privacy principles which are substantially different, and the void that we see here in Australia contrasts significantly, while the EC is moving towards a set of privacy principles which apply throughout the community—including in the UK, where we have substantial assets.*⁴¹

7.43 The APCC commented that Australia was 'in danger of becoming isolated in its response to privacy concerns, with potentially serious consequences for business confidence and investment and international trade, as well as leaving its citizens with a sub-standard privacy protection regime'.⁴²

38 Price Waterhouse, *Privacy Survey 1997*, Melbourne, p. 3.

39 The Australian Privacy Charter Council, *Submission*, p. S415.

40 The Australian Privacy Charter Council, *Submission*, p. S415.

41 Mr Michael Coomer, National Australia Bank, *Transcript*, 3 February 1998, p. 599.

42 The Australian Privacy Charter Council, *Submission*, p. S415.

7.44 The Information Policy Advisory Council (IPAC), in its consideration of privacy and other matters, addressed the issue of government intervention.⁴³ IPAC stated:

The thrust of this report is that it is in the commercial interest of the industry to produce market solutions for what users value. Moreover, there is considerable scope for both consumers and government to encourage and promote the development of such market-based solutions. It is IPAC's view that recourse to 'safety net' regulatory intervention should only happen in the face of demonstrated evidence of the market failing to respond to basic user requirements and where it can be shown that there is a public good to be preserved through regulatory intervention.⁴⁴

7.45 At the round table forum, the APCC suggested that privacy legislation was not only required for privacy reasons but also for trade reasons, 'because it seems very unlikely that, on any assessment of Australia's current laws, the European Union (EU) would judge us to be adequate in terms of their directive'.⁴⁵ For these same reasons, the APCC also suggested that the EU would not trade with the US. The Privacy Commissioner also commented:

It is reasonable to assume that Australia would be seen by the EU as protecting privacy to an adequate standard in those sectors to which the Privacy Act applies. It is also reasonable to assume that the Australian private sector generally would not meet the test of adequate privacy protection, except where individual companies have entered contractual agreements with EU entities that contain sufficient guarantees that the privacy and fundamental rights of the individual concerned will be protected.⁴⁶

43 Information Policy Advisory Council, *A national policy framework for structural adjustment within the new Commonwealth of Information*, Commonwealth Department of Communications and the Arts, August 1997, p. 28.

44 Information Policy Advisory Council, *A national policy framework for structural adjustment within the new Commonwealth of Information*, p. 28.

45 Mr Nigel Water, Australian Privacy Charter Council, *Transcript*, 3 February 1998, p. 606.

46 Office of the Privacy Commissioner, *Submission* p. S343.

7.46 During 1997 the NAB, together with other organisations from the private sector, worked with the Privacy Commissioner to help progress a self-regulatory privacy regime. It is from this background and experience that the NAB is questioning the effectiveness of a self-regulatory approach which it argues may not provide a sufficient level of confidence, internationally. The NAB states:

Despite the National's concerns about unduly restrictive regulations, and the costs of compliance, it tends to the view that privacy legislation is the most effective means of ensuring efficiency and effectiveness. However, as indicated above, privacy principles should be general in nature and methods of storage and use of information not be unduly restrictive.⁴⁷

7.47 The NAB commented that 'unless Australia moves more rapidly in the areas of privacy and security, there is a danger that on these grounds alone, Australia will miss valuable and employment creating commercial opportunities'.⁴⁸

7.48 At the Committee's round table forum, the NAB qualified its views commenting that its 'support for whether it is self-regulation or legislation is strongly predicated on the nature and content of any privacy principles which may be put into place'.⁴⁹

7.49 There were some groups, in evidence to the inquiry, that supported a self-regulatory privacy regime. The Attorney-General's Department reported that:

The government is having discussions with the European Commission about what will be required to treat Australia as having adequate privacy protection, which is the term used in the directive...it may well be the case that we will not

47 National Australia Bank, *Submission*, p. S492.

48 National Australia Bank, *Submission* p. S492.

49 Mr Ian McLean, National Australia Bank, *Transcript*, 3 February 1998, p. 597.

*need to have legislation in place, that enforcement mechanisms might be provided through a self-regulatory code which has real enforcement mechanisms.*⁵⁰

7.50 The Australian Bankers' Association advised that it 'would like to see a self-regulatory approach at least be given an opportunity to work and see how it turns out'.⁵¹

Privacy in the US and Canada

7.51 The Clinton Administration supports the establishment of a self-regulatory privacy regime, and is supporting private sector efforts to achieve this outcome.⁵² President Clinton's *Framework* document noted that countries are choosing either industry self-regulation or legislation to achieve privacy outcomes. In particular, the *Framework* document noted that the EU has adopted a directive that prohibits the transfer of personal data to countries that, in its view, do not extend adequate privacy protection to EU citizens. To address this issue, the US stated that it 'will engage key trading partners in discussions to build support for industry-developed solutions to privacy problems'.⁵³

7.52 The US, however, is keeping its options open. It commented that if industry cannot achieve effective privacy outcomes, then 'we will reevaluate this policy'. Clinton's *Framework* document stated:

*If privacy concerns are not addressed by industry through self-regulation and technology, the Administration will face increasing pressure to play a more direct role in safeguarding consumer choice regarding privacy online.*⁵⁴

50 Ms Kathy Leigh, Attorney-General's Department, *Transcript*, 3 February 1998, p. 609.

51 Mr Ross Robins, Australian Bankers' Association, *Transcript*, 3 February 1998, p. 617.

52 Clinton Administration, *A Framework for Electronic Commerce*, 1 July 1997, [www.iitf.nist.gov/elecomm/ecommm.htm].

53 Clinton Administration, *A Framework for Electronic Commerce*, 1 July 1997, [www.iitf.nist.gov/elecomm/ecommm.htm].

54 Clinton Administration, *A Framework for Electronic Commerce*, 1 July 1997, [www.iitf.nist.gov/elecomm/ecommm.htm].

7.53 In contrast, Canada has chosen to introduce privacy legislation governing the protection of personal information in the private sector.⁵⁵ The Canadian Government discussed three key reasons why it is introducing legislation. First, it cited concerns that modern communications technology and software allows personal information to be tracked and a data base maintained. Second, is the concern that voluntary codes for protecting privacy may not be uniform which could create confusion for business and consumers. The Canadian Government stated:

*Not all businesses or industry associations have undertaken voluntary measures, and there may be a short-term incentive for some companies to ignore such measures and to use personal information inappropriately. This can undermine fair competition in the marketplace, creating an unlevel playing field. It can also erode consumer confidence in an entire industry and create further confusion about rights and rules.*⁵⁶

7.54 The third priority for the Canadian Government was to ensure that its measures were consistent with the 1995 EU *Directive on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data*. The Canadian Government commented that 'failure to provide adequate protection for personal information may put Canada at risk of having 'data flows' from the European Union blocked'.⁵⁷

7.55 The Canadian Government also suggested that without legislation, business compliance costs in meeting EU directives could be greater. This was because individual Canadian businesses may be forced to undertake individual

55 Task Force on Electronic Commerce, Industry Canada, Justice Canada, *The Protection of Personal Information - Building Canada's Information Economy and Society*, January 1998, [http://strategis.ic.gc.ca/privacy].

56 Task Force on Electronic Commerce, Industry Canada, Justice Canada, *The Protection of Personal Information - Building Canada's Information Economy and Society*, p. 7.

57 Task Force on Electronic Commerce, Industry Canada, Justice Canada, *The Protection of Personal Information - Building Canada's Information Economy and Society*, p. 8.

contractual negotiations to show compliance with the EU rules. The Canadian Government suggested that this 'process will be fraught with uncertainty and could become lengthy and expensive'.⁵⁸

Opposition to State legislation

7.56 During the round table forum, the prospect was raised that some States and Territories may introduce their own privacy legislation to cover the private sector. The Victorian Treasurer and Minister for Multimedia, the Hon Alan Stockdale, MLA, is reported to favour national privacy legislation, and warns that voluntary codes would not be enough to guarantee privacy in the information age. In addition, Mr Stockdale warned that business should not be subject to different standards in different jurisdictions.⁵⁹

7.57 The NAB was also opposed to separate state legislation claiming that it would lead to a fragmented approach that would be confusing for business. The NAB suggested that the possibility of separate state legislation was analogous to the problems created by different state railway gauges and different FID and Debits tax.⁶⁰ In conclusion, the NAB stated that it did not support any state legislation on this matter commenting that 'we have some very substantial concerns about the activities of state governments in introducing inconsistent, restrictive, costly and internationally uncompetitive privacy legislation'.⁶¹

7.58 The Attorney-General's Department advised that the Prime Minister, at a Council of Australian Governments meeting during 1997 requested Premiers not to legislate on privacy so as to avoid a fragmented approach, and that the Privacy Commissioner would be available to help develop a

58 Task Force on Electronic Commerce, Industry Canada, Justice Canada, *The Protection of Personal Information - Building Canada's Information Economy and Society*, p. 8.

59 *Australian Financial Review*, 27 April 1998, p. 24.

60 Mr Ian McLean, National Australia Bank, *Transcript*, 3 February 1998, p. 596.

61 Mr Ian McLean, National Australia Bank, *Transcript*, 3 February 1998, p. 596.

nationally consistent standard. The Attorney-General has also raised the same issue at meetings of the Standing Committee of Attorneys-General.⁶²

Conclusions

7.59 Consumer protection and privacy are threshold issues for the successful development of internet commerce. Internet commerce does present a range of new challenges in achieving adequate consumer protection and privacy. Linked with these matters is the need to ensure effective levels of security and authentication.

7.60 Consumer protection is complicated by the international dimension of internet commerce. Domestic consumer protection laws will have no power in cases where suppliers are located in other countries. At the same time, the opportunity for consumers to seek redress through other countries' legal processes is limited. Therefore, international cooperation and agreement will be required.

7.61 The Committee notes the participation of the Australian Competition and Consumer Commission in international 'sweep days' in which a range of international law enforcement agencies search for corrupt and fraudulent activities on the world wide web. The Committee supports this type of activity, and also the development of international industry codes of conduct. It is in the interest of business, both domestically and internationally, to raise consumer confidence by providing adequate levels of consumer protection.

7.62 A key requirement in achieving consumer protection and privacy is the achievement of secure transactions. The internet is an open system and security of transactions is not assured. A solution to this is the use of encryption technology. For internet commerce to flourish, encryption technology must be readily available. Therefore, the Committee rejects any restrictions on the use of encryption technology. In arriving at this conclusion, the Committee notes the competing needs of

62 Ms Kathy Leigh, Attorney-General's Department, *Transcript*, 3 February 1998, p. 609.

various government agencies. The Committee, in particular, rejects the use of a 'key escrow' system in which government agencies could gain access to the encryption keys provided by trusted third parties.

7.63 The Australian Government is moving to introduce a self-regulatory privacy regime for the private sector. Some groups, in evidence to the inquiry, rejected this strategy and called for the government to legislate on this matter. These groups point out that other countries such as New Zealand, Hong Kong, Taiwan, South Korea, Malaysia, Singapore and countries of the European Union (EU) are introducing legislation to regulate the private sector. The Australian Privacy Charter Council (APCC) claims that the laws of the EU will restrict the transfer of personal data to countries without adequate privacy protection. The APCC claimed that Australia's self-regulatory approach would not satisfy the EU with serious consequences for international trade.

7.64 The National Australia Bank (NAB) also rejected a self-regulatory privacy regime and called for the government to legislate as the most effective means of ensuring efficiency and effectiveness. The Australian Bankers' Association supported a self-regulatory privacy regime.

7.65 The Committee took particular note of the arguments for and against a self-regulatory privacy regime. The Committee concludes that a legislated privacy regime will be more effective than a self-regulatory approach. Privacy legislation for the private sector will ensure better coverage, receive international recognition, and will discourage state governments from passing their own legislation.

7.66 The Committee does not take this position lightly. Internet commerce must be left to develop in an environment in which private sector firms respond to market forces. The role of government should be minimal and directed at providing certainty for both consumers and business through a light touch regulatory regime. In particular, the Committee accepts self-regulatory approaches wherever possible. These are principles which the Committee supports and which have been consistent themes throughout this report. At the same time, these principles need to be applied on a case by case basis with each issue being subject to policy and administrative analysis. In the case of privacy, there is overwhelming evidence for legislation.

7.67 First, the Committee is not persuaded that a self-regulatory privacy regime will have sufficient enforcement provisions to ensure compliance. Mr Ira Magaziner, Senior Advisor on Policy Development to President Clinton, commented that governments would be wasting their time trying to legislate because they could not enforce their laws.

7.68 Magaziner argues that market forces, in which consumers exercise choice, will ensure compliance. Companies complying with industry codes would be permitted to display a seal or symbol on their website to show that they were abiding by privacy principles.⁶³ In response to this, the Committee agrees that legislation will not ensure full compliance. There will always be groups that seek to gain from acting outside the law. However, with Magaziner's proposal there will be even more room for business to act outside the guidelines.

7.69 In a legislated privacy regime, companies ignoring the legislation would be acting illegally and their business credibility could be destroyed if they were revealed. Under a self-regulatory approach, there is no legal incentive for a company to comply, and it is problematic that consumer confidence would be adversely affected if it was shown that a company was not complying with privacy principles. A self-regulatory approach requires that all consumers be adequately informed and able to make rational economic decisions. Unfortunately this is not the case and, therefore, it is possible that companies ignoring self-regulatory privacy codes could continue to operate.

7.70 A second issue is the importance of consumer confidence in ensuring the growth of internet commerce. Internet users must have reasonable confidence that their privacy is protected. The Committee believes that privacy legislation, particularly in the short term, will be more effective than self-regulation in raising consumer confidence. This is based on some of the comments raised in the previous paragraphs regarding levels of consumer knowledge and information.

63 Mr Ira Magaziner, Senior Advisor on Policy Development to the President of the US, Enabling Australia Conference, 16 April 1998, Canberra.

7.71 Third, there is not sufficient evidence showing that business supports a self-regulatory approach. For example, the Price Waterhouse Privacy Survey revealed that, of those businesses surveyed, 70 per cent supported legislation. In evidence to the inquiry, the National Australia Bank supported the introduction of legislation. The Committee is aware that the Victorian Government prefers the introduction of privacy legislation. In addition, the Victorian Government would prefer the Commonwealth Government to introduce overarching privacy legislation. If the Commonwealth continues with its preference for a self-regulatory privacy regime then the Committee believes that Victoria will legislate. In this event, New South Wales and other states would probably follow.

7.72 If the States pass their own privacy legislation then the Federal Government's self-regulatory privacy regime will be made redundant. The private sector would have a clear incentive to comply with a State legislated privacy regime and will ignore the Federal Government's self-regulatory approach. Under this scenario, the Federal Government would eventually be forced to legislate. During this chain of events, national corporations may have to comply with privacy legislation from a number of individual states which could introduce confusion and significantly add to compliance costs.

7.73 The Committee notes that the US supports a self-regulatory approach to privacy. This was confirmed by Mr Ira Magaziner, Senior Advisor on Policy Development to President Clinton, at the Enabling Australia conference on 16 April 1998 in Canberra. President Clinton, through the *Framework* document, stated that 'we will reevaluate this policy' if privacy concerns are not addressed by industry. This can be interpreted in a number of ways and does not automatically mean that the US will legislate. However, if the US did choose this path 12 months down the track then Australia would be seriously isolated with its policy choice.

7.74 Finally, the Committee does not accept that a legislated scheme, in contrast to self-regulation, will create more compliance costs for business. At the same time, it is not expected that there will be a significant increase in government expenditure. The ACCC, for example, could monitor compliance with privacy legislation as part of its overall responsibility to administer the Trade Practices Act. For these reasons, the Committee recommends that the Government develop privacy legislation for the private sector.

7.75 Recommendation 17

That the Australian Government introduce privacy legislation, with specific reference to information communications, to govern the use of personal information in the private sector.

Bob Charles MP
Chairman
27 May 1998



APPENDIX I – SUBMISSIONS

1. Matt Francis
2. Tourism Development Consultant
3. Robert Draper
4. Australian Society of Certified Practising Accountants
5. Systems Consultant
6. Richard J. Slater
7. Boating Industry Association of Australia Limited
8. Stephen Withers
9. East Coast Antique Auto Parts
10. Telstra Multimedia
11. Jewellers Association of Australia Limited
12. Standards Australia
13. Marschall Acoustics Instruments Pty Ltd
14. CAPEC Pty Ltd
15. www.consult pty limited
16. Hugh Pattinson
17. Australian Retailers Association
18. Customs Brokers Council of Australia Inc.
19. Australia Post

20. Department of Commerce and Trade
Government of Western Australia
21. Australian Federation of International Forwarders
22. Australian Bankers Association
23. Young Media Australia
24. Australian Customs Service
25. Coopers & Lybrand
26. Australian Bureau of Statistics
27. The Australian Fishing Tackle Association Inc
28. Attorney-General's Department
29. Coles Myer Ltd
30. Department of Primary Industries and Energy
31. Optus Communications
32. Arthur Andersen
33. The Australian and New Zealand Association of
Antiquarian Booksellers Limited
34. Department of Administrative Services
35. Australian Competition & Consumer Commission
36. Internet Industry Association
37. International Banks Securities Association of
Australia
38. CAPEC Pty Limited
(supplementary submission)
39. Human Rights and Equal Opportunity Commission
Office of the Privacy Commissioner
40. Australian Science, Technology and Engineering
Council

41. Department of Foreign Affairs and Trade
42. Industry Commission
43. Standards Australia
(supplementary submission)
44. Australian Society of Certified Practising
Accountants
(supplementary submission)
45. Australian Music Retailers Association
46. The Institute of Chartered Accountants in Australia
47. Coopers & Lybrand
(supplementary submission)
48. The Australian Privacy Charter Council
49. Department of Industry, Science and Tourism
50. Commonwealth Law Enforcement Board
51. Australian Taxation Office
52. National Australia Bank
53. British Telecom Asia Pacific
54. Telstra Corporation Ltd
55. Department of Communications and the Arts
56. Professor William J. Caelli
57. Australian Bureau of Statistics
(supplementary submission)
58. Australian Music Retailers Association
(supplementary submission)
59. Australian Trade Commission
60. Commonwealth Bank of Australia

61. John P. McAuley
62. Department of Communications and the Arts
(supplementary submission)
63. Nutritional Foods Association
64. Coles Myer Ltd
(supplementary submission)
65. Industry Commission
(supplementary submission)
66. Department of Industry, Science and Tourism
(supplementary submission)
67. Coles Myer Ltd
(supplementary submission)
68. Australian Customs Service
(supplementary submission)
69. The Australian Fishing Tackle Association Inc
(supplementary submission)
70. Department of Industry, Science and Tourism
(supplementary submission)
71. Customs Brokers Council of Australia Inc
(supplementary submission)
72. Australian Customs Service
(supplementary submission)
73. The Australian Fishing Tackle Association Inc
(supplementary submission)
74. Customs Brokers Council of Australia
(supplementary submission)
75. Australian Customs Service
(supplementary submission)
76. Australian Customs Service
(supplementary submission)

77. Customs Brokers Council of Australia Inc
(supplementary submission)
78. Industry Commission
(supplementary submission)
79. The Australian Fishing Tackle Association Inc
(supplementary submission)
80. Coles Myer Ltd
(supplementary submission)
81. CAPEC Pty Ltd
(supplementary submission)
82. International Air Courier Association of Australia
83. Australia Post
(supplementary submission)

The Committee also received confidential submissions.

II

APPENDIX II – EXHIBITS

1. Australian Information Industry Association Ltd, *The Online Economy – AIIA Position Paper*.
2. Ben J. Mettes.
3. Australian Federation of International Forwarders Ltd – Article for Tradegate by Brian Lovell.
4. *Small Screen Digest*, No. 119, August 1997.
5. Shelly Pasnick, *Responsible Advertising to Children and Youth in the New Online Environment*.
6. Australian Customs Service, Final report – *Commercial Screen for Air Cargo Shipments Not Requiring Formal Customs Entry*, April 1996.
7. Coopers & Lybrand, Report – *Financial Institutions Duty and Debits Tax: Constraints on Australia's Future in a Global Financial Market*. March 1996.
8. *Melton International Tackle*, 1997 Catalogue.
9. Report of the Electronic Commerce Task Force to the Commonwealth Law Enforcement Board.
10. *Copyright Law in Australia*, 1996 Booklet.
11. Discussion Paper, *Copyright Reform and the Digital Agenda*, July 1997.
12. News Release, *Copyright Reform and the Online Environment*, 6 August 1997.

13. Joint Media Release, *Government Addressing Copyright Challenges*.
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15. Australian Science, Technology and Engineering Council, *President's Commission on Critical Infrastructure Protection*.
16. Australian Science, Technology and Engineering Council, *Global Trading Posts: still a proving ground*.
17. Australian Science, Technology and Engineering Council – Example internet service order form.
18. Price Waterhouse, *Proposal for an Increase of the Commercial Entry Threshold*, 16 July 1997.
19. Australian Securities Commission, *Inquiry into Global Electronic Capital Raising and Share Trading: ASC's Response* – Issues Paper.
20. Australian Fishing Tackle Association, Comparative Price List.
21. Fantec Enterprise, Correspondence.
22. Bluefin Fishing Tackle, Correspondence.
23. Australian Fishing Tackle Association, Statistics.
24. Bass Pro Order Form.
25. Customs Brokers Council of Australia, Correspondence.
26. An example of Air Waybill from Concord International, Mumbai.
27. Standards Australia, various documents.

28. Australia Post, Flow Chart on incoming international parcels.
29. Australian Society of Certified Practising Accountants, *Comments on ATO Discussion Paper on the Electronic Commerce Project on Tax and the Internet*.
30. Department of Industry, Science and Tourism, *Benchmarks for Industry Based Customer Dispute Resolution Schemes*.
31. The National Advisory Council on Consumer Affairs, *Consumer Protection in Electronic Commerce*.
32. Federal Bureau of Consumer Affairs, *Untangling the Web*.
33. Commonwealth Law Enforcement Board, *Terms of Reference*.
34. Commonwealth Law Enforcement Board, *Executive Summary*.
35. Security in Government 97 Conference, Keynote Address *The New Security Risk Environment*, by Federal Attorney-General, the Hon Daryl Williams, AM QC MP.
36. Coles Myer Ltd, *Spring Catalogue 1997*.
37. AC Nielsen, *Survey of Low Value Importations*, Report on stage 2: Pilot Test Survey.

Confidential Exhibits

The Committee received a number of confidential exhibits.



APPENDIX III – WITNESSES AT PUBLIC HEARINGS

Canberra 20 October 1997

Attorney-General's Department

Ms Jenny Clift
Legal II

Mr Chris Creswell
Acting First Assistant Secretary

Mr Keith Holland
Assistant Secretary

Mr Stephen Orłowski
Special Advisor

Mr John Schmidt
Senior Advisor

Australian Customs Service

Mr Graeme Austin
Director

Mr John Drury
Deputy Chief Executive Officer

Jewellers Association of Australia

Mr Peter Gulbransen
Director

Mr Colin Pocklington
Industry Representative

Mr Chris Reeves
Executive Director

Canberra 27 October 1997

Australian Competition and Consumer Commission

Mr Allan Asher
Acting Chairman

Ms Jacqueline Pearce
Project Officer

Mr David Wright
Project Officer

Austrade

Ms Helen Monro
Manager

Australian Science, Technology and Engineering Council

Professor William Caelli
Council Member

Mr David Nicholls
Director

Department of Foreign Affairs and Trade

Dr Michael Adams
Acting Assistant Secretary

Sydney 5 November 1997

Australian Federation of International Forwarders

Mr Brian Lovell
Chief Executive Officer

Australian Fishing Tackle Association

Mr Lawrence Webb
President

Mr John Dunphy
Vice President

Mr Brian Hale
Secretary

Australian Retailers Association

Mr David Shetliffe
Director

CAPEC Pty Ltd

Mr Kenneth Muldoon
Secretary

Citizens

Mr Paul McNab

Mr Hugh Pattinson

Customs Brokers Council of Australia

Mr Robert Fraser
Board Director

Mr Stephen Morris
Executive Director

Mr Kent Gordon Heazlett
Past Chairman

Internet Industry Association

Mr Richard Cousins
Chairman

Mr Patrick Fair
Deputy Chairman

Mr Michael Ward
Alternate Director

M Con Boulougouris
Solicitor (Phillips Fox)

Sydney 6 November 1997

Australian and New Zealand Association of Antiquarian Booksellers

Ms Susan Tompkins
President

Citizen

Dr Richard Marschall

Human Rights and Equal Opportunity Commission

Mr Paul Kelly
Director

International Banks and Securities Association of Australia

Ms Lindy Smith
Director

Dr David Lynch
Director of Policy

Standards Australia

Mr Terry Ehret
Associate Director – Information

Mr Roger Lyle
Associate Director – Communications Technologies

Telstra Corporation Ltd

Mr Darren Adam
Taxation Advisor

Mr John Burke
Group General Manager

Mr Peter de Jong
Deputy General Counsel

Telstra Multimedia Pty Ltd

Mr John Simon
General Manager

Melbourne 14 November 1997

Arthur Andersen

Mr Anthony Stolarek
Managing Director

Mr Damian Walsh
Partner

Australia Post

Mr Christopher Grosser
Group Manager International

Mr Gerry Ryan
Corporate Secretary

Australian Bankers Association

Mr Ross Robins
Senior Analyst

Australian Society of Certified Practising Accountants

Mr Michael McKenna
Executive Director

Mr Andrew Kent
Director IT and Communications

Coles Myer Ltd

Mr Tom Curtis
Manager

Canberra 15 December 1997

Australian Bureau of Statistics

Mr Robert Edwards
First Assistant Statistician

Mr Robert McColl
Director

Mr Russell Rogers
Assistant Statistician

Australian Taxation Office

Mr Michael Carmody
Commissioner of Taxation

Mr Frank Merrick
Assistant Commissioner

Mrs Ariane Pickering
International Tax Counsel

British Telecom Asia Pacific

Ms Elizabeth Williams
Senior Regulatory Adviser

Department of Communications and the Arts

Mr Simon Bryant
Director

Dr Simon Pelling
Director

Mr Brian Stewart
Assistant Secretary

Department of Finance and Administration

Mr Clive Hawkins
Acting Director

Mr William Peel
First Assistant Secretary

Department of Primary Industries and Energy

Mr Noel Beynon
Manager

Mr Ian Crellin
Senior Advisor

Mr Jim Graham
Senior Advisor

Dr Onko Kingma
Assistant Secretary

Department of Industry, Science and Tourism

Mr Ross James
Manager

Mr John Griffiths
Acting General Manager

Mr Benjamin Healy
Assistant Manager

Mr Philip Noonan
First Assistant Secretary

Mr Michael Todd
Leader

Optus

Mr Omar Khalifa
Marketing Manager

Mr Reaymond McGuinness
Lawyer

Telstra Corporation Ltd

Mr John Rolland
General Manager

Mr Darren Adam
Taxation Adviser

Mr Phil Sparton
National General Manager

Ms Deanne Weir
Regulatory and External Affairs

Treasury

Mr Bruce Paine
Assistant Secretary

www.consult pty limited

Mr Ramin Marzbani
Managing Director

Canberra 16 December 1997

Australian Music Retailers Association

Mr Ross Gengos
Deputy Chairman

Mr Robert Walker
Executive Officer

Commonwealth Law Enforcement Board

Ms Elizabeth Montano
Member

Industry Commission

Mr John Cosgrove
Commissioner

Dr Stephen Rimmer
Director

Dr Tony Warren
Consultant

National Australia Bank

Mr Ian McLean
Manager

Mr Roderick Carr
General Manager

Mr Michael Durrant
Practice Leader

Canberra 3 February 1998

Austrade

Mr Greg Joffe
Corporate Advisor

Mr Lloyd Bennett
General Manager

Australian Competition and Consumer Commission

Mr Alan Asher
Deputy Chairman

Australian and New Zealand Association of Antiquarian Booksellers

Dr Martin Nagle
Internet Consultant

Arthur Andersen

Mr Tony Stolarek
Managing Director

Mr Damian Walsh
Partner

Australian Taxation Office

Mr Jim Killaly
Deputy Commissioner

Mr Paul Bray
Assistant Commissioner

Mr Frank Merrick
Assistant Commissioner

Mrs Ariane Pickering
International Tax Counsel

Attorney-General's Department

Mr Peter Ford
First Assistant Secretary

Mr Steve Orlowski
Special Advisor

Mr John Schmidt
Senior Advisor

Ms Kathy Leigh
Assistant Secretary

Australian Bankers Association

Mr Ross Robins
Associate Director

Australian Bureau of Statistics

Mr Russell Rogers
Assistant Statistician

Mr Bob McColl
Director

Australian Consumers Association

Ms Mara Bun
Manager

Australian Customs Service

Mr John Drury
Deputy Chief Executive Officer

Mr Graeme Austin
Director

Mr Peter Gulbrandsen
Director

Australian Fishing Tackle Association

Mr Lawrie Webb
President

Mr John Dunphy
Vice President

Australia Post

Mr Chris Grosser
Group Manager

Mr Gerry Ryan
Corporate Secretary

Australian Privacy Charter Council

Mr Nigel Waters
Vice President

Australian Retailers Association

Mr David Shetliffe
Director

Australian Society of Certified Practising Accountants

Mr Michael McKenna
Executive Director

Mr David Johns
Technical Support

Citizen

Mr Paul McNab

Conference of Asian Pacific Express Carriers (CAPEC)

Mr Ken Muldoon
Secretary

Coles Myer Ltd

Mr Tom Curtis
Manager

Customs Brokers Council of Australia

Mr Stephen Morris
Executive Director

Department of Communications and the Arts

Mr Brian Stewart
Assistant Secretary

Department of Foreign Affairs and Trade

Dr Mike Adams
Director

Department of Industry, Science and Tourism

Mr Mike Todd
Leader

Mr Peter Moore
Manager

Mr Mike Stracey
Manager

Mr Phillip Noonan
Head of Division

Mr Peter Clarke
Manager

Mr John Griffiths
Acting General Manager

Mr Rodney Bourke
Manager

Internet Industry Association

Mr Michael Ward
Manager

National Australia Bank

Mr Ian McLean
Group General Manager

Mr Michael Coomer
Executive Director

*Human Rights and Equal Opportunity Commission
Office of the Privacy Commissioner*

Ms Moira Scollay
Privacy Commissioner

Mr Paul Kelly
Director

Treasury

Mr Bruce Paine
Assistant Secretary

Mr Paul Lindwall
Director

Mr Kevin McNamara
Senior Policy Advisor

Mr Michael Rosser
Director

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Mr Ramin Marzbani
Managing Director

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