

OECD publishes consolidated International VAT/GST Guidelines

Executive summary

On 6 November 2015, the Organisation for Economic Cooperation and Development (OECD) published its consolidated *International VAT/GST Guidelines* (the Guidelines). The publication of the Guidelines is the outcome of a long-lasting and inclusive process that started in the late 1990s and involved some non-OECD economies as well as business representatives, including EY.

The consolidated Guidelines were adopted by the OECD's member countries, by being approved at the level of its highest body for tax matters, the Committee on Fiscal Affairs, on 7 July 2015. However, they remained under embargo until they received wider endorsement by non-OECD economies. This happened at the third meeting of the OECD Global Forum on VAT, held in Paris on 5-6 November 2015, where more than 100 countries and international organizations gathered to discuss the Guidelines. With wide-reaching global consensus, the Guidelines now set the international standard for the VAT/GST treatment of international trade in services and intangibles.

Detailed discussion

OECD International VAT/GST Guidelines

The Guidelines are a response to the tremendous growth of cross-border trade over the last decades and the corresponding risk of inconsistencies between different VAT systems applying different tax treatments. Their aim is to avoid double taxation and unintended non-taxation. The Guidelines are not a

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“*Model VAT/GST Act*” or the equivalent to the OECD Model Tax Convention containing suggested legislative provisions. Rather, they are more comparable to the *OECD Transfer Pricing Guidelines*, as they identify objectives and suggest means for achieving them and individual governments are invited to follow the Guidelines in the way that best fits their systems.

The Guidelines consist of four chapters:

- ▶ **Chapter 1** sets the scene by defining the core features of value added taxes covered by the Guidelines. It defines them as broad-based taxes on final consumption collected from businesses through a staged collection process but in principle not borne by them. The Guidelines apply to taxes generally known as VAT or GST (Goods and Services Tax), but for ease of reading only the terms “value added tax” and “VAT” are used.
- ▶ **Chapter 2** is dedicated to the neutrality of VAT and identifies six principles laid down in Guidelines 2.1 through 2.6. This chapter covers the various dimensions of neutrality, which is not limited to the recoverability of the tax but also includes the absence of discrimination and the elimination of disproportionate or inappropriate compliance costs for businesses.
- ▶ **Chapter 3** is the longest and deals with the most important topic: determining the place of taxation for cross-border supplies of services and intangibles. Based notably on information supplied by its business representatives, the OECD took the view that, due to border controls, the VAT treatment of international trade in goods is causing relatively fewer difficulties than the international trade in services, as exported goods are generally free of VAT while imported goods are taxed in the country of delivery and are thus treated on the same footing as local supplies of goods. Consequently, the Guidelines do not deal at all with the trade of goods and focus exclusively on cross-border supplies of services and intangibles. The OECD explicitly mentions that “intangibles” are included, as some VAT/GST jurisdictions around the world do not regard transactions involving intangible assets (such as patents or trademarks) to be supplies of services.
- ▶ **Chapter 4** sheds light on the practical application of the Guidelines. Jurisdictions are encouraged to use existing bilateral, regional or multilateral arrangements on mutual co-operation (such as the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters* developed jointly by the OECD and the Council of Europe). In this chapter, the OECD also invites jurisdictions to support a

consistent approach to the Guidelines, through taxpayer services such as the provision of clear local guidance (such as commentaries and circular letters) and the creation of points of contact.

Recommended place of taxation for cross-border supplies of services and intangibles

The destination principle: in Chapter 3, the Guidelines recognize as overarching principle that VAT neutrality in international trade is generally achieved through the implementation of the “destination principle” of taxation. The destination principle is designed to ensure that tax on cross-border supplies is ultimately levied only in the jurisdiction where the final consumption occurs. Guideline 3.1 states: “For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption.”

Consumption: the Guidelines do not define consumption for the application of this general principle, but use proxies to establish where consumption should reasonably be assumed to take place. As a first step, the Guidelines make a distinction between business-to-business supplies (B2B) and business-to-consumer supplies (B2C) and define two different proxies called “general rules” for these two different kinds of supplies.

B2B supplies: for B2B supplies, the general rule for the place of taxation is the location of the customer. Guideline 3.2 states: “For the application of Guideline 3.1, for business-to-business supplies, the jurisdiction in which the customer is located has the taxing rights over internationally traded services and intangibles.”

One challenging issue for the application of the general rule is the supply of a service or intangible to a legal entity with multiple locations (called a “multiple location entity” or “MLE”). For supplies to an MLE, the place of taxation should be the location of the establishment using the service or intangible. Guideline 3.4 states: “For the application of Guideline 3.2, when the customer has establishments in more than one jurisdiction, the taxing rights accrue to the jurisdiction(s) where the establishment(s) using the service or intangible is (are) located.” The Guidelines recognize three different approaches and emphasize that none of should take precedence but that they are all equal:

- ▶ The direct use approach, which focuses directly on the establishment that uses the service or intangible.

- ▶ The direct delivery approach, which focuses on the establishment to which the service or intangible is delivered.
- ▶ The recharge method, which focuses on the establishment that uses the service or intangible as determined on the basis of internal recharge arrangements within the MLE, made in accordance with corporate tax, accounting or other regulatory requirements.

It is worth noting that the *OECD International VAT/GST Guidelines* contain their own definition of the term “establishment” for VAT purposes and they do not refer to article 5 of the *OECD Model Tax Convention* (see footnote 24 on page 31). The definition reads: “For the purpose of these Guidelines, it is assumed that an establishment comprises a fixed place of business with a sufficient level of infrastructure in terms of people, systems and assets to be able to receive and/or make supplies. Registration for VAT purposes by itself does not constitute an establishment for the purposes of these Guidelines. Countries are encouraged to publicise what constitutes an “establishment” under their domestic VAT legislation.” This should support the principle that a permanent establishment for direct tax purposes cannot give automatically rise to an establishment for VAT purposes, notably in respect to Action 7 of the *G20/OECD Base Erosion and Profit Shifting (BEPS) Project* on preventing the artificial avoidance of permanent establishment status.

B2C supplies: for B2C supplies, the Guidelines distinguish two general rules: one for so-called “on-the-spot supplies” and one for other kinds of supplies.

For “on-the-spot supplies” the rule is the place of physical performance. Guideline 3.5 states: “For the application of Guideline 3.1, the jurisdiction in which the supply is physically performed has the taxing rights over business-to-consumer supplies of services and intangibles that

- ▶ are physically performed at a readily identifiable place, and
- ▶ are ordinarily consumed at the same time as and at the same place where they are physically performed, and
- ▶ ordinarily require the physical presence of the person performing the supply and the person consuming the service or intangible at the same time and place where the supply of such a service or intangible is physically performed.”

For other kinds of supplies, the B2C general rule is close to the B2B general rule, as it is based on the residence of the customer. Guideline 3.6 states: “For the application of Guideline 3.1, the jurisdiction in which the customer has

its usual residence has the taxing rights over business-to-consumer supplies of services and intangibles other than those covered by Guideline 3.5.”

The Guidelines also recognize that, in some situations, the general rules may not lead to the appropriate place of taxation. The Guidelines do not list all these situations and provide other rules for each. Rather they describe an assessment framework in which such situations can be identified and for which another proxy, called a “specific rule,” could be adopted. The assessment framework is the same for B2B and B2C supplies. Guideline 3.7 states:

“The taxing rights over internationally traded services or intangibles supplied between businesses may be allocated by reference to a proxy other than the customer’s location as laid down in Guideline 3.2, when both the following conditions are met:

- a. The allocation of taxing rights by reference to the customer’s location does not lead to an appropriate result when considered under the following criteria:
 - Neutrality
 - Efficiency of compliance and administration
 - Certainty and simplicity
 - Effectiveness
 - Fairness
- b. A proxy other than the customer’s location would lead to a significantly better result when considered under the same criteria.

Similarly, the taxing rights over internationally traded business-to-consumer supplies of services or intangibles may be allocated by reference to a proxy other than the place of performance as laid down in Guideline 3.5 and the usual residence of the customer as laid down in Guideline 3.6, when both the conditions are met as set out in a. and b. above.”

The only area where the Guidelines explicitly admit that a specific rule may be appropriate, but, in any case, without recommending it, is for immovable property. Guideline 3.8 states: “For internationally traded supplies of services and intangibles directly connected with immovable property, the taxing rights may be allocated to the jurisdiction where the immovable property is located.”

Finally, the Guidelines also address the important issue of simplified registration and VAT collection when the supplier is not established in the country where the VAT is due. For

B2B supplies, the Guidelines recommend the application of the reverse-charge mechanism if the business customer is established in the country of taxation. For B2C supplies, the Guidelines recommend the registration of the supplier but in a simplified way. A simplified registration and compliance regime for nonresident suppliers of B2C services and intangibles would likely operate separately from the traditional registration and compliance regime, without the same rights (e.g., input tax recovery) and obligations (e.g., full reporting) as a traditional regime. More details are set out in Guidelines 3.135 through 3.154.

Practical consequences for businesses

The *OECD International VAT/GST Guidelines* are not legally binding but only constitute “soft law” aimed at persuading jurisdictions to implement them into “hard” national law. Businesses cannot, therefore, derive any rights out of the Guidelines that can be used before a national court or take any action against the tax administration based on an incompatibility between national law and the Guidelines (as may be the case, for example, with the *European Union VAT Directive*).

However, the Guidelines are a strong political signal and they have wide commitment from many countries. Therefore, businesses can expect positive changes in VAT legislation and a better harmonization of VAT rules worldwide that should reduce the risk of double taxation. Many jurisdictions around the world still tax many B2B supplies of services (e.g., advisory services), at the supplier’s place of establishment (using the origin principle). The adoption of Guidelines provides a unique opportunity to align the taxation of more and more services worldwide so that they are taxed in the jurisdiction where the business customer is established. Last, but not least, the Guidelines describe more explicitly and more thoroughly the reasons behind the VAT treatment of cross-border trade in services and intangibles than national laws generally do. In that respect, the Guidelines can help businesses to interpret national VAT law in the light of these reasons in their discussions with tax administrations and in cases take before national courts, based on a recognized international standard.

Impact

The Guidelines should be formally approved in 2016 by the OECD Council, which is the highest OECD body where member countries are represented by their ambassadors or ministers. Although approval at this level is symbolic, this should grant the Guidelines the highest level of moral authority and reinforce governments’ commitment in respecting them.

The OECD intends to undertake further work on the practical application of the Guidelines and to subsequently set out an implementation package giving more precise guidance to businesses. Finally, the OECD Global Forum on VAT has made a list of potential future topics to work on. This work could include research and analysis of approaches to improve neutrality and the overall performance of VAT systems, such as through the design and implementation of efficient VAT refund mechanisms and risk assessment processes. This work could also include the development of a possible framework for the exchange of information and enhanced administrative co-operation in the area of VAT. Future work could also focus on the application of VAT to cross-border trade in goods, including work on the collection of VAT on low value imports, and on good practices to address compliance issues. Work might also be needed on the interaction between VAT and the international direct tax framework, notably in the area of transfer pricing.

The full text of the Guidelines can be accessed at <http://www.oecd.org/tax/consumption/international-vat-gst-guidelines.pdf> and the statement of outcomes of the OECD Global Forum on VAT at <http://www.oecd.org/ctp/consumption/statement-of-outcomes-on-vat-gst-guidelines-2015.pdf>.

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