OECD releases public discussion draft on international VAT/GST Guidelines

Executive summary

On 18 December 2014, the Organisation for Economic Co-operation and Development (OECD) released a discussion draft in connection with the international Value Added Tax (VAT)/Goods and Services Tax (GST) Guidelines (the Guidelines). The document titled Guidelines on Place of Taxation for Business-to-Consumer Supplies of Services and Intangibles (Guidelines) and Provisions on Supporting the Guidelines in Practice (Supporting Provisions) (the Discussion Draft or the Draft) describes two draft elements of the Guidelines. The first element, relating to the Guidelines, addresses a VAT/GST matter discussed in the “Report on Tax Challenges of the Digital Economy,” which was issued under Action 1 (Digital Economy) as part of the work on the OECD’s Action Plan on Base Erosion and Profit Shifting (BEPS).

The Discussion Draft provides guidance on the place of taxation issues with respect to business-to-business (B2B) as well as business-to-consumer (B2C) supplies of services and intangibles, including recommendations for collecting VAT/GST on cross-border supplies of services and intangibles, particularly for nonresident suppliers. In this context, the Draft recommends that nonresident B2C suppliers should be required to register for and remit VAT/GST in the jurisdiction of their customers. The Draft suggests implementing simplified registration and compliance regimes to facilitate compliance. In addition, the B2C Guidelines provide recommendations for strengthening international administrative cooperation to ensure effective collection of VAT/GST on cross-border supplies of services and intangibles.

The Guidelines in question, which seek to determine the place of taxation for cross-border B2C supplies of services and intangibles, have been integrated into the existing Chapter 3 of the OECD International VAT/GST Guidelines.
The second element of the Discussion Draft, the Supporting Provisions, sets out suggested means by which the Guidelines could be implemented into national legislation in a manner that provides for consistency across taxing jurisdictions while reducing the risk of double taxation or unintended taxation.

The OECD has requested comments on the Discussion Draft to be submitted by 20 February 2015. The OECD has indicated its intention to have a public consultation on the Draft and the comments received on 25 February 2015.

Detailed discussion
The main issues addressed in the Discussion Draft are summarized below.

**Place of taxation – Destination principle**
The main aim of the destination principle set forth in the Guidelines is to ensure tax neutrality within the VAT system by levying VAT in the jurisdiction where the consumption of goods, services and intangibles occurs.

For this purpose, according to the Discussion Draft, the B2B place of taxation rules should focus on where business customers consume items used to produce the goods, services and/or intangibles that final consumers will purchase. They should further focus on enabling the flow-through of the tax burden to the final consumer while at the same time maintaining VAT neutrality.

The Discussion Draft acknowledges that taxing jurisdictions have different aims and procedures when it comes to taxing B2B as compared to B2C supplies of services and intangibles. Accordingly, it provides separate Guidelines for B2B and B2C supplies, without requiring jurisdictions to develop separate rules or implement different mechanisms for each type of supply.

In addition, the Guidelines recognize that while the place of taxation rules should be aimed at identifying where businesses actually use the services or where final consumption takes place, it is not always possible for the supplier to know where consumption will occur at the time when VAT is required to be charged. Therefore, VAT systems generally use proxies for the place of business use or final consumption to determine the place of taxation based on aspects of the supply that are or can be determined at the time the transaction occurs. In this respect, the Discussion Draft encourages taxing jurisdictions to provide clear practical guidance on how suppliers could establish the status of their customers (business or non-business), for example considering adopting a requirement for suppliers to provide a customer’s VAT registration number or tax identification number, or other such indicia (such as information available in commercial registers), to establish their customer’s status.

**B2C supplies of services and intangibles – General rules**
In the B2C context, the objective is to tax the final consumption in the jurisdiction where it takes place with the tax burden resting on the final consumer. Accordingly, the place of taxation rules seek to predict with reasonable accuracy the place where the services or intangibles are likely to be consumed while taking into account practical constraints. In this context, the Draft states that the place of taxation rules should be as simple and as straightforward as possible.

According to the Discussion Draft, it would be appropriate to use the consumer location in determining the place of taxation for supplies of services and intangibles where the place of consumption of those services and intangibles bears no relationship to the place where the supply is made or where the supplier is located. In this respect, the customer location is where customers have their usual residence and it provides a clear connection to a readily identifiable place. Using the customer location ensures that the services and intangibles acquired by final consumers from foreign suppliers are taxed on the same basis and at the same rate as domestic supplies. Therefore, the Draft indicates that there should not be any tax advantage for final consumers in buying from a low or no VAT jurisdiction. Another advantage of using customer locations as a proxy, as set out in the Discussion Draft,
is the relative ease of application and practicality of such a place of taxation rule, as long as a simplified registration and compliance regime is available and is supported by effective international cooperation in tax administration and enforcement.

Based on these considerations, the Discussion Draft recommends two general rules for determining the place of taxation for B2C supplies of services and intangibles:

- For supplies that are physically performed at a readily identifiable location and that are ordinarily consumed at the same time and place where they are physically performed in the presence of both the person performing the supply and the person consuming it (“on-the-spot supplies”), a place of taxation rule based on the place of performance.

- For supplies that are not covered by the above “on-the-spot” rule, a place of taxation rule based on the customer’s usual residence.

**B2C supplies of services and intangibles – “On-the-spot supplies”**

For “on-the-spot supplies” of services and intangibles, the Discussion Draft suggests that the place of physical performance of the supply is the appropriate proxy to determine the place of taxation. This should be a simple and practical approach for suppliers as well as tax administrators to adopt. The “on-the-spot” guidance is aimed primarily at supplies that are made for immediate consumption at an identifiable place of performance, rather than supplies that can be provided remotely or that may be consumed in the future (e.g., restaurant and catering services; entry to cinema, theatre performances, trade fairs, museums; attendance at sports competitions, etc.). The Discussion Draft points out that such an approach would be applicable in both the B2B and B2C contexts.

**B2C supplies of services and intangibles – Other than “on-the-spot” supplies**

For supplies of services and intangibles that do not meet the conditions set out above, such as services and intangibles which can easily be supplied remotely, the place of physical performance or the supplier’s location is not a good proxy. Hence, the Discussion Draft recommends the place of usual residence of the customer as an appropriate proxy in a B2C scenario as “it can be assumed that these types of services and intangibles will ordinarily be consumed in the jurisdiction where the customer has his or her usual residence.” Examples include consultancy, accountancy and legal services; financial and insurance services; long-term rental of movable property; telecommunication and broadcasting services; online supplies of software and software maintenance; online supplies of digital content, among others.

**Determining the jurisdiction of the usual residence of the customer**

The usual residence of the customer of a B2C supply refers to where the customer regularly lives or has established a home. This should not include the temporary or transitory residence of customers (e.g., the residence of tourists). In this respect, for scenarios encompassing e-commerce, the Discussion Draft recommends that countries provide clear, realistic and practical guidance from the supplier’s perspective. In a B2C scenario, suppliers should be able to rely on information they routinely collect from customers in the course of their business in determining the place of taxation. The Discussion Draft also recommends that tax authorities should find a balance between laws and practice in their jurisdictions, in particular with respect to privacy laws.

**VAT collection in cases where the supplier is not located in the jurisdiction of taxation**

Under the traditional approach, the nonresident supplier of services and intangibles is required to register in the jurisdiction of taxation and is required to charge, collect and remit any tax due there, which can be a burdensome and complex process. For such cross-border B2B supplies of services and intangibles, the Guidelines recommend the implementation of a reverse charge mechanism to reduce the administrative burden and complexity for the suppliers in question. This reverse charge mechanism would shift the tax liability from the supplier to the customer and would mitigate the supplier’s VAT registration and VAT accounting requirement in the customer’s jurisdiction.
However, according to the Draft, such a reverse-charge system is not considered to be an appropriate solution for the B2C supply of services and intangibles as it would be a difficult and costly process to administer and the rate of compliance would likely be low in the absence of meaningful sanctions for failure of consumers to comply.

Simplified registration and compliance requirements for nonresident B2C suppliers

According to the Discussion Draft, at the present time, the most effective and efficient approach to ensure the appropriate collection of VAT on cross-border B2C supplies of services and intangibles is to require the nonresident supplier to register and account for VAT in the jurisdiction of taxation. In this respect, the Discussion Draft recommends taxing jurisdictions to implement simplified registration and compliance regimes for nonresident suppliers of B2C services and intangibles which would operate separately from the traditional registration and compliance regime.

The Discussion Draft proposes that VAT requirements for B2C suppliers of services and intangibles be simplified in the areas of registration, input tax recovery, returns, payments, record keeping, invoicing, availability of information, and the use of third party service providers. Simplifications proposed include reducing the level of information required to be included on applications for VAT registration, returns and invoices and other records and providing for consistency in this respect across taxing jurisdictions. Additionally, the use of electronic payment and filing mechanisms is recommended, as is making information in respect of the compliance process readily available to suppliers via the internet.

While simplification is recommended in the Draft Discussion as a key means of ensuring VAT compliance by nonresident B2C suppliers of services and intangibles, with a registration-based collection mechanism, the Draft considers it necessary to support the enforcement of the simplified compliance measures by means of increased international cooperation between taxing jurisdictions in VAT administration. Such cooperation is considered vital to achieving the proper collection and remittance of VAT on cross-border supplies of services and intangibles by nonresident suppliers.

B2C supplies of services and intangibles – Specific rules

In certain scenarios, the Discussion Draft finds that the general rule based on the place of physical performance of “on-the-spot” supplies of services and intangibles may not lead to an appropriate tax result. The Draft provides the example of where the physical performance of a supply occurs in multiple jurisdictions and tax obligations could therefore arise in all of those jurisdictions (e.g., the international transport of persons).

Another example of where the general rule may not lead to an accurate tax result, relating to the place of the usual residence of the customer rule, is when services and intangibles performed at an easily identifiable location require the physical presence of the person consuming the supply but not the physical presence of the supplier, such as the provision of internet access in an internet café or a hotel lobby. In such cases, the Draft states it is reasonable to suppose that suppliers know or are able to know the actual location of the customer at the time of consumption and jurisdictions may consider using the actual location of the consumer at the time of the supply as a proxy for place of consumption rather than usual residence.

The Draft states that specific rules may also be appropriate for cases where the supply of services and intangibles is directly related to tangible property, in particular with respect to immovable property (in both a B2B and B2C context) as well as movable tangible property (in a B2C context). Generally, the location of the tangible property would be considered the best means of determining the place of taxation.

The Draft clarifies that the specific rule should only apply to “services directly connected with immovable property.” The application of the rule should be limited to cases where the immovable property is “clearly identifiable” and “at the heart of” the supply of such services.

Examples of services and intangibles in connection with movable property include services that are physically carried out on specific movable
property, such as repairing, altering or maintaining the property, and the rental of specific movable property where this is considered a service. According to the Draft, it is recommended to use the physical location of movable tangible property as a means of identifying the place of taxation of supplies of services and intangibles connected with such property. This recommendation is made on the basis that the location of the movable property should reflect the place where the services and intangibles are consumed. Additionally, it is considered a relatively straightforward rule to implement. However, the Draft clarifies that for B2B supplies of services and intangibles connected with movable property, the application of the general rule based on customer location will generally lead to an inappropriate result.

The Discussion Draft stresses that the Guidelines are not meant to be seen as providing for specific rules and that specific rules should only be provided for when the application of the general rule would lead to an inappropriate VAT result. In such scenarios, an evaluation of the matter should be carried out and a specific rule implemented only if it would result in a significantly better tax result than under the general rule. This emphasis is made in the light of the risk of differences arising in the interpretation and application of specific rules with different proxies between jurisdictions (thereby increasing the possibility of double taxation and unintended non-taxation).

Enhanced cooperation and taxpayer services by taxing authorities
The Discussion Draft recommends that jurisdictions take steps toward increasing the use of existing OECD instruments for exchange of information and other forms of mutual administrative assistance that may assist jurisdictions in strengthening and enhancing international cooperation in the field of VAT.

Additionally, the Discussion Draft provides for increased communication between taxpayers and the taxing authorities by means of establishing tax authority “points of contact” to whom taxpayers can go to address concerns over domestic VAT rules within the scope of the Guidelines and the interpretation and implementation of the Guidelines by taxing jurisdictions.

Implications
The Discussion Draft provides guidance on the place of taxation issues with respect to the B2C supply of services and intangibles, the considerations to be taken into account from both a business perspective and a tax administration perspective, and the practical implications of the implementation of the Guidelines. The main aim of the Guidelines is to find a balance between various VAT principles such as neutrality, efficiency and fairness. The Draft suggests that specific rules should be limited to circumstances where the general rules may not lead to an appropriate result. The recommendations with respect to the implementation of such a framework into local law take into consideration the risk and avoidance of double taxation and unintended non-taxation resulting from inconsistencies in the application of VAT to international trade, putting emphasis on mutual cooperation as well as exchange of information to ensure the effective collection of VAT.

Companies should continue to monitor developments with respect to the Guidelines, evaluate how any proposed changes may impact them, and stay informed about VAT developments in the OECD and in the countries where they operate or invest. In this regard, many jurisdictions already have or are intending to introduce changes to the manner in which they tax B2C supplies of services similar to those outlined in the Guidelines.
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