



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



APPLYING VAT/GST TO CROSS-BORDER TRADE IN SERVICES AND INTANGIBLES

EMERGING CONCEPTS FOR DEFINING PLACE OF TAXATION – OUTCOME OF THE FIRST CONSULTATION DOCUMENT

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CENTRE FOR TAX POLICY AND ADMINISTRATION

WORK ON INTERNATIONAL VAT/GST GUIDELINES

EMERGING CONCEPTS ON PLACE OF TAXATION – OUTCOME OF PUBLIC CONSULTATION

Background

1. In February 2006 the Committee on Fiscal Affairs (CFA) launched a project aimed at providing guidance for governments on applying Value Added Taxes or Goods and Services Tax to cross-border trade. This would be done by developing the International OECD VAT/GST Guidelines. The immediate focus of the guidelines will be on services and intangibles, with trade in goods being dealt with later. In this context, the CFA has agreed on two fundamental principles for charging VAT/GST on internationally traded services and intangibles:

- For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption¹ ;
- The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.

2. The transcription of these fundamental principles into guidelines requires a clearer definition of the meaning of “jurisdiction of consumption”. There is agreement that defining place of taxation under a “pure consumption” test would, in most cases, be impractical and approximations (“proxies”) should be used as practical means for determining the place of consumption. In most situations, the place of consumption should be deemed to be the jurisdiction where the customer is located (“main rule”).

3. Work on developing such a definition is being undertaken by a Technical Advisory Group (TAG), consisting of representatives of governments and businesses, and academics. This work gave rise to a first paper on fundamental concepts, published on the OECD website for public comments in January 2008. The period for comments ended on 30 April 2008.

Outcome of public consultation

4. The OECD has received comments on that paper from seven businesses and business associations, namely:

- The Chartered Institute of Taxation – UK
- Confédération Fiscale Européenne
- Fédération Bancaire Française
- AstraZeneca

¹ Luxembourg has a reservation on this principle.

- Kesaia Daunibau (Fiji)
- Comité Européen des Assurances
- The Canadian Institute of Chartered Accountants

General comments

5. All the comments received welcomed the OECD work in this area and supported the consultation process. They also agreed on the “destination principle” adopted by the CFA (taxation should occur in the jurisdiction of consumption) and on the proxy adopted as a main rule for cross-border Business-to-Business transactions (i.e. the place where the customer is established). There is also an agreement on the principle that each transaction should be treated independently.

6. However, the comments raised several issues:

- a) There is a need for clarification of the definition of some of the concepts used in the document. These concepts include:
 - i. “Intangibles”. The document does not provide the reason for using the expression “services and intangibles”. It may be worth an explanation in future documents for public consultation;
 - ii. “Legal entity”. In certain countries (e.g. UK) two or more persons may be treated as a taxable person even though there is not a separate legal entity. In the EU, several separate legal entities may be treated as a single taxable person (“VAT Grouping”). Some suggested using the term “taxable entity” rather than “legal entity”;
 - iii. Goods/services. Difference in categorisation for some supplies (e.g. lease of goods) may result in double or unintended non taxation.
- b) Since the reverse charge mechanism is recommended as an appropriate tax collection mechanism for cross-border transactions, it should be made clear that it is not recommended for domestic transactions and B2C transactions. Some pointed out the cash flow advantage that the reverse charge may provide compared to the tax/deduction mechanism.
- c) Further work is required on some issues such as:
 - i. Branch to Branch transactions and treatment of VAT groupings;
 - ii. Valuation of cross-border supplies e.g. in relation to Customs concepts for some bundled supplies and for transactions between related parties;
- d) There is a need for a dispute resolution mechanism in cases where differences of interpretation of the rules remain between jurisdictions.

7. Some European commentators pointed out possible differences of treatment that may emerge between the new EU VAT Directive on place of taxation for B2B services (to enter into force in January 2010) and the OECD draft Guidelines for specific situations which may derogate from the Main Rule.

Specific comments on cases

8. All the comments approved the solutions for Steps 1 and 2. For Step 3, some suggested clarifying that the reverse charge mechanism is recommended for cross-border supplies only and not for domestic supplies.

9. Regarding Steps 4 and 5 some comments raised the question of the solution for these cases if FFCA/FFCB or CBMA/CBMB would be branches/head offices or part of a VAT grouping. Some raised the question of artificial cash flow advantage provided by the use of the reverse charge in cases where the services are purportedly “routed” through a foreign country (but such a situation is excluded in paragraph 6 of the document since all scenarios are, for the purpose of this work, supposed to be supported by legitimate and bona fide economic substance).

10. The TAG recognises that the cross-border supplies of services and intangibles between parts of the same legal entity (e.g. branch-to-branch) raises specific issues. These will be dealt with at a later date.