

Centre for Tax Policy and Administration

Consumption Tax Guidance Series: Paper No 1

Electronic Commerce – Commentary on Place of Consumption for Business-to-Business Supplies (Business Presence)

Commentary on Place of Consumption for Business-to-Business Supplies (Business Presence)

Caveat

Consumption Tax Guidance is a means of developing greater awareness of both policy and administrative issues. On policy issues the Guidance contains recommendations to member governments that are aimed at removing conflicts, distortions and disincentives to international trade. The section on administrative issues has been developed as a result of sharing experiences between member countries. The OECD's Committee on Fiscal Affairs has approved the contents and countries are encouraged to apply the guidance wherever possible. Nothing contained herein binds member countries, although where there is clear consensus amongst the member countries, administrations should consider the guidance in the light of their existing taxation systems and their legislative approaches.

COMMENTARY ON PLACE OF CONSUMPTION FOR BUSINESS-TO-BUSINESS SUPPLIES (BUSINESS PRESENCE)

1. A key principle at the basis of the Ottawa Taxation Framework Conditions for consumption taxes is that the rules for the consumption taxation of cross-border electronic commerce should result in taxation in the jurisdiction where consumption takes place.

2. The *Guideline on the Definition of the Place of Consumption for the Taxation of Cross Border Services and Intangible Property in the Context of E-Commerce* (the Guideline on the Definition of the Place of Consumption) provides two guidelines for business to business e-commerce transactions for determining the place of consumption for cross-border supplies of services and intangible property made to non-resident business recipients. These two guidelines are referred to in this guidance paper as a “main criterion” and an “override criterion”.

3. The main criterion states that the place of consumption for cross-border supplies of services and intangible property that are capable of delivery from a remote location made to a non-resident business recipient should be the jurisdiction in which the recipient has located its business presence¹.

4. As the main criterion can be considered to be a “proxy” for a pure consumption test (*i.e.* one that approximates where actual consumption occurs), in certain circumstances, countries may use a different criterion to determine the actual place of consumption where the application of the main criterion would lead to a distortion of competition or avoidance of tax², *e.g.* resulting from the routing of services through establishments in non-tax or low-tax jurisdictions. This is referred to as the “override criterion”.

5. The Guideline on the Definition of the Place of Consumption clarifies the application of the Guidelines as follows³:

- a) In the context of value-added or other general consumption tax systems, the Guidelines are intended to define the place of consumption (and so the place of taxation) for the international cross-border supply of services and intangible property;
- b) The Guidelines apply to the cross-border supply of services and intangible property, particularly in the context of international cross-border electronic commerce that are capable of delivery from a remote location;
- c) The Guidelines do not apply to services which are not capable of direct delivery from a remote location (for example, hotel accommodation, transportation or vehicle rental). Nor are they applicable in circumstances where the place of consumption may be readily ascertained, as is the case where a service is performed in the physical presence of both the service provider and the customer (for example, hairdressing), or when the place of consumption can

¹ Paragraph 3 of the Guideline on the Definition of the Place of Consumption.

² Paragraph 4 of the Guideline on the Definition of the Place of Consumption.

³ Paragraph 6, 7 and 8 of the Guideline on the Definition of the Place of Consumption.

more appropriately be determined by reference to a particular criterion (for example, services related to particular immovable property or goods). Finally, it is recognised that specific types of services, for example, some telecommunications services, may require more specific approaches to determine their place of consumption.

6. The focus of this guidance is to provide commentary building on, but not changing, the Guidelines in the Guideline on the Definition of the Place of Consumption, particularly in instances where the customer has multiple locations.

Application of the Main Criterion

7. The Guideline on the Definition of the Place of Consumption notes in footnote 2 that the business presence is in principle the establishment of the recipient to which the supply is made.

8. Both business and government members of the Consumption Tax TAG have underlined the importance of contracts in determining the business presence to which the supply is made. By looking at contracts, taxing authorities, suppliers and customers would be able to evidence transactions and justify the treatment given to supplies. Looking at normal commercial practices would appear to be a reasonable approach, as generally, VAT/GST administrations rely on normal commercial practices which are evidenced in the contracts (*e.g.* invoicing, terms of payment, use of intellectual property rights).

Application of the Override Criterion

9. As noted in the Guideline on the Definition of the Place of Consumption, in certain circumstances, countries may use a different criterion to determine the actual place of consumption, where the application of the approach under the main criterion would lead to distortion of competition or avoidance of tax. In work leading up to the Guideline on the Definition of the Place of Consumption the application of a pure consumption test was examined and it was concluded that this would be burdensome for both business and revenue administrations. However, in cases where competitive distortions or tax avoidance may arise applying the pure consumption test is the only real alternative. Such application may be made, for example, where one or more consuming entities are not entitled to recover the input tax on a transaction that is routed through an associated business presence in a no or low-tax jurisdiction, thus avoiding a significant amount of tax.

10. Where a country invokes the override criterion, it may choose to require a business presence in its jurisdiction to account for tax only to the extent of consumption taking place in that jurisdiction.

1. Where a country invokes the override criterion the host country of the business presence that is considered to have received the supply under the main criterion, may choose to provide a partial credit of its tax which it collected under the main criterion. This credit would be equivalent to that portion of the host country's tax that is attributable to the consumption that is being taxed by the country invoking the override rule. Tax administrations involved in the application of the override criterion should strive to avoid unintentional non-taxation or double taxation.

12. To illustrate, consider a business situated in country A that has contracted for a supply worth \$1000 with 30% of the supply being consumed in country B. The rate of tax is 10% in country A and 20% in country B. In this case country A would require the business to reverse charge on the full value of the supply (\$1000 x 10% or \$100). If country B invokes the override criterion, it would collect \$60 (\$1000 x 30% x 20%). Country A may subsequently provide a credit of \$30, which is equivalent to that portion of country A's tax collected under the main criterion which is attributable to the consumption being taxed by country B (\$1000 x 30% x 10%). The net result is that country A and B each tax the value of the consumption that is occurring in their jurisdictions - \$70 in country A and \$60 in country B.

Conclusion

13. The Guidelines on the Definition of the Place of Consumption do not apply to services which are not capable of direct delivery from a remote location or where the place of consumption may be readily ascertained.

14. Where the main criterion is applied, the place of consumption of cross-border electronically delivered services and intangible property is the jurisdiction in which the recipient's business presence is located. Normal commercial practices as evidenced in the terms of the contract (*e.g.* invoicing, terms of payment, use of intellectual property) should normally provide sufficient indicative evidence to assist both business and revenue administrations in determining the jurisdiction of consumption.

15. Countries may use a pure consumption test to determine the place of consumption where the application of the approach under the main criterion would lead to distortion of competition or avoidance of tax. Where a country invokes this approach, it may choose to require a business presence in its jurisdiction to account for tax only to the extent that consumption takes place in that jurisdiction. Where a country invokes this test the host country of the business presence that is considered to have received the supply under the main criterion, may choose to provide a partial credit of its tax which it collected under the main criterion. This credit would be equivalent to that portion of the host country's tax that is attributable to the consumption that is being taxed by the country invoking the override rule.