All Working Party No. 9 Delegates are invited to review the attached "Fourth Draft of Possible Guidelines on the Place of Consumption for Services Traded Internationally", in advance of, and in preparation for, the meeting of the Working Party No. 9 Sub-group on Electronic Commerce to be held at OECD Headquarters on 21-22 September 2000.

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INTRODUCTION TO THE FOURTH DRAFT OF POSSIBLE “GUIDELINES” ON THE PLACE OF CONSUMPTION FOR SERVICES TRADED INTERNATIONALLY

Background

1. This note concerns the fourth draft of possible “guidelines” on the principle of taxation in the place of consumption.

2. At the Working Party No. 9 (WP9) meeting on 9 June 2000, a discussion re-emerged on the fundamental issue of the scope of application of the proposed guidelines and how that scope should be expressed. Several Delegations argued in favour of a specific reference to digitised services and products (“narrow” approach), rather than a broader reference to the wide range of intangible products and services that e-commerce facilitates when traded internationally (“broad” approach).

3. To resolve this problem, it was agreed that the Secretariat would circulate a new draft of the guidelines with both approaches [DAFFE/CFA/WP9(2000)/REV2] to all WP9 Delegates for written comment. These approaches were formulated in the form of two options: an Option A describing the scope of the guidelines as applicable to the cross-border supply of services and intangible products that are capable of delivery from a remote location; and an Option B limiting the scope of the guidelines to the cross-border supply of digitised products and services.

Summary of the responses

4. Of the 23 responses received by the Secretariat to date (13 September 2000), 16 are in favour of Option A and seven in favour of Option B. This means that a substantial majority (more than two thirds) of the Delegations who replied expressed a preference for a “broad” definition of the scope of the guidelines, albeit that many of them suggested some improvements.

5. The Delegations expressing a preference for Option B (“narrow” approach) presented four main arguments:

   - Option A, in proposing guidelines for all cross-border trade of intangible products and services, exceeds the scope of the Ottawa Taxation Framework Conditions, which are targeted in the first instance at achieving a solution to the taxation problems arising from electronic commerce, rather than attempting to resolve (longer-standing) issues concerned with conventional commerce.

   - Option A seems to be too ambitious in the short term, given the reduced possibility of agreement within the current timeframe as to the treatment of internationally traded services more generally.

   - The legal structure of the taxation rules in the European Union (Sixth VAT Directive), and of the current European Commission proposal concerning the taxation of certain e-commerce transactions, starts from an approach, which is much more akin to Option B.

   - Since Option A has a very broad scope – which covers all cross-border supply of services and intangible products – it is necessary to make a number of “exclusions” from the general principle. But these “exclusions” seem to be numerous and relatively unclear, so it would appear simpler to directly indicate the targeted intangible products and services, which is the rationale under Option B.
6. Amongst the Delegations favouring Option A (“broad” approach), three main arguments were cited:

- Option A better meets the requirements of the Ottawa Taxation Framework Conditions for neutrality between conventional and electronic forms of commerce in as far as taxation rules should not depend on the means of delivery of the product.

- Option B does not either meet the requirements for predictability and simplicity insofar as, if it treats all “digitised” products and services in the same manner, it leaves a large number of areas in an “unpredictable” category. Furthermore, there is no guarantee against the development of different rules in different jurisdictions for those products and services that are only capable of digitised delivery.

- Option B refers to “digitised products and services” without providing a definition of a “digitised service” (are architects’ services or legal advice transmitted through Internet included?) and so leaves scope for confusion. Establishing a list of products and services, which would be considered as “digitised”, would not meet the requirements of simplicity and predictability. Furthermore, such a list would seem to require constant updating by virtue of new emerging products and services.

7. It should be noted that some Delegations favouring Option A also criticised the wording of the “exclusions” (paragraph 5 of the draft guidelines) from the general principle arguing, for example, that they seemed to be too numerous and relatively unclear.

Analysis

8. The fundamental observation that might be made in considering the responses is that no Delegation questioned the aim of the Guidelines, which is to more fully express how application of the Taxation Framework Conditions can create an equitable fiscal environment between conventional and electronic forms of commerce. No one called for a specific regime solely to apply to electronic commerce transactions.

9. Nevertheless some important questions have been raised concerning the scope and the nature of such guidelines, notably with regard to the Ottawa Taxation Framework Conditions. Some Delegations argued that Option A exceeds the scope of their implementation in defining a rule for the all-international commerce in services.

10. The origin of this problem lies in a certain ambiguity in the Ottawa Taxation Framework Conditions and the documents on which the work of the subsidiary bodies is founded. In fact, these documents use the expressions “taxation of cross-border transactions” and “e-commerce taxation” interchangeably. The reason for this ambiguity lies in the underlying question as to the rules that should be modified or prescribed in order to tax e-commerce in the same way as traditional cross-border trade, considering that the latter follows notably two main “widely accepted general tax principles” (Taxation Framework Conditions, paragraph 9):

- Consumption taxation should occur in the jurisdiction of consumption.
- There should be an equitable treatment between all forms of commerce.

11. With that perspective in mind, the aim of the proposed guidelines is to define the means to create an equitable fiscal environment for e-commerce, with regard for these general principles, rather than attempting to go onto resolving long-standing issues concerned with traditional cross-border commerce. On the other hand, it would appear inconsistent with the neutrality principle, as expressed in the Taxation Framework Conditions, to limit the application of the principle of taxation at the place of permanent address/business presence only to the digitised goods and services.

12. It is with a view to these two parallel aims that the scope of the guidelines has been defined (paragraphs 3 to 5 of the third draft). On one hand, the scope includes all the intangible products and services that are capable of delivery from a remote location, but on the other hand it excludes from its application all the
transactions that are beyond the scope of the Taxation Framework Conditions (services related to real property or goods, telecommunication services, etc.).

13. In the view of many Delegates, whatever Option they favoured, it appeared that the wording of paragraph 5 of the third draft of the guidelines lacked clarity on this point. For this reason, paragraph 5 has been changed in the attached fourth draft in order to clarify its scope in defining the exclusions more generally.

14. A number of Delegations, all members of the European Union, expressed their concern about the fact that Option A did not comply, in their view, with the European Union VAT rules, nor with the latest European Commission’s proposal on taxation of e-commerce. Since Option A has a broader scope, it does not reflect the legal structure of these European rules.

15. These remarks reveal that the intended role and objectives of the guidelines have perhaps not been explained sufficiently clearly in the earlier drafts. It is thus very important to stress that OECD guidelines do not have the same significance as a legal text, nor the same need for precision. They are only intended to reflect a common foundation as to the agreed outcome (i.e. taxation in the place of consumption) with the detailed application remaining a matter for domestic legislation. To this extent Option A can be seen as an expression of current, accepted consumption tax principles. But it is not intended to represent a legal text, and so should not be analysed in that vein.

Other remarks

16. Some Delegations proposed a clarification concerning paragraph 7 on the place of consumption for business-to-business transactions. In light of these remarks, the text (and footnotes) has been reworded.

17. To ensure consistency of terminology in the draft guidelines – and in keeping with the terms of the Taxation Framework Conditions – the word “jurisdiction” has been adopted when referring to the place of taxation.
FOURTH DRAFT OF POSSIBLE “GUIDELINES” ON THE PLACE OF CONSUMPTION FOR SERVICES TRADED INTERNATIONALLY

Introduction

1. In 1998, OECD Ministers welcomed a number of Taxation Framework Conditions relating to the consumption taxation of electronic commerce in a cross-border trade environment, including:
   i) In order to prevent double taxation, or unintentional non-taxation, rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.
   ii) For the purpose of consumption taxes, the supply of digitised products should not be treated as a supply of goods.
   iii) Where businesses acquire services and intangible property from a non-resident vendor, consideration should be given to the use of reverse charge, self-assessment or other equivalent mechanism.

2. The guidelines below are intended to achieve the practical application of the Taxation Framework Conditions, particularly in the context of international cross-border electronic commerce. Member countries are encouraged to introduce the mechanisms necessary to implement the guidelines, at the same time as any necessary control and enforcement measures.

Application

3. In the context of value-added or other general consumption tax systems, these 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 products by non-resident vendors/suppliers that are not otherwise required to register in the destination jurisdiction under existing mechanisms.  

4. These guidelines apply to the cross-border supply of services and intangible products that are capable of delivery from a remote location.

5. The guidelines do not, therefore, apply to services which are not capable of direct delivery from a remote location (for example hairdressing, repair of tangible goods, 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 presence of both the service provider and the customer, or when the place of consumption can 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, telecommunications services, may require more specific approaches to determine their place of consumption.

1. While these guidelines are not intended to apply to sub-national value-added and general consumption taxes, attention will need to be given to the issues presented, in the international context, relating to these taxes.

2. The objective is to ensure certainty and simplicity for businesses and tax administrations, as well as neutrality via equivalent tax implications for the same products in the same market (i.e. avoiding competitive distortions through unintentional non-taxation).
Guidelines

“Business to business”

6. The place of consumption for supplies of services and intangible products made to a non-resident business recipient should be the jurisdiction in which the recipient has located its business presence.3

7. Countries are encouraged to consider the application of a use and enjoyment test where the application of the approach in paragraph 6 would lead to a distortion of competition or avoidance of tax. Such a test should normally only be applied in the context of a reverse charge or self-assessment mechanism (see Recommendations on Tax Collection Mechanisms).

“Business to private consumer”

8. The place of consumption for supplies of services and intangible products made to a non-resident private recipient should be the jurisdiction in which the recipient has their usual place of residence.4

3. The “business presence” is the establishment of the recipient that receives and utilizes the supply. This may include a headquarters, registered office, or a branch of the business. Where the supply is used in multiple locations the place of consumption may be deemed to be the main location of the business (usually the headquarters).

4. It is recognised that implementing this guideline will not always result in taxation in the actual place of consumption. Under a “pure” place of consumption test, intangible services are consumed in the place where the customer actually uses the services. However, the mobility of communications is such that to apply a pure place of consumption test would lead to a significant compliance burden for vendors.
Recommended approaches to the practical application of the guidelines

“Business to business”

1. Member countries should consider the use of a reverse charge, self-assessment or other equivalent mechanism in respect of these transactions.5

“Business to private consumer”

2. [“Recommended” collection mechanism(s)].

5. As per the Taxation Framework Conditions, countries are encouraged to collect tax on business-to-business transactions through a “reverse charge” or equivalent system. Under such a system the business recipient declares the tax due as if it were a supply (sale) by the business recipient itself. At the same time the recipient is entitled to a credit in the same way as if it had made the purchase from a supplier within its own jurisdiction (countries may wish to waive the reverse charge where an input tax credit or deduction of input tax would otherwise be available). Such a system would protect revenues while ensuring the competitiveness of domestic suppliers.