



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

### EMERGING CONCEPTS FOR DEFINING PLACE OF TAXATION – SECOND CONSULTATION DOCUMENT

Invitation for comments

JUNE 2008

Committee on Fiscal Affairs  
Working Party N°9 on Consumption Taxes



CENTRE FOR TAX POLICY AND ADMINISTRATION



## IMPORTANT NOTICE

*This second document for public consultation follows on from the first public consultation document placed on the OECD website in January 2008 (available at <http://www.oecd.org/dataoecd/42/11/39874228.pdf>). Comments received from this first consultation were supportive of the approaches taken by the OECD (Summary available at XXX). No substantive changes to these approaches were identified.*

*This second consultation document contains examples of cross-border supplies of services and intangibles that are more complex than in the first document in that they involve supplies between multi-national companies under global agreements. As with the first report these examples are subject to the conditions set out in paragraphs 1 and 2 of the present document.*

*The attention of participants is drawn to the fact that this document reflects work in progress and that solutions or conclusions that are presented should not be considered, at this stage, as part of the guidelines. Draft guidelines will be presented for consultation at a later stage as a result of the work of the Committee.*

*This document does not necessarily reflect the views of either the OECD nor of its member countries.*

*When commenting, we ask you to identify yourself in the questionnaire attached to this document as we may need to follow-up on your responses. Subject to prior authorisation by commentators, we may publish some of the contributions received on our internet site.*

*Input can be provided by individuals or on a more collective basis by industry bodies or by professional advisory firms. Should you need further information please do not hesitate to contact David Holmes, Head of Consumption Taxes Unit ([David.Holmes@oecd.org](mailto:David.Holmes@oecd.org)) or Stéphane Buydens, Administrator ([Stephane.Buydens@oecd.org](mailto:Stephane.Buydens@oecd.org)).*

*Please send your reply either by mail, fax or e-mail to the following address by 17 October 2008:*

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## **EMERGING CONCEPTS FOR DEFINING PLACE OF TAXATION FOR CROSS-BORDER SUPPLIES OF SERVICES AND INTANGIBLES**

### **SECOND CONSULTATION DOCUMENT**

1. The following conditions are applied in the examples.

- In each of the scenarios the main rule, customer location, is applied;
- Only business to business supplies are considered;
- Operations in all scenarios are based on and supported by legitimate and bona fide economic substance;
- The scenarios focus on an ideal regulatory environment; existing legislation and practices are ignored; and
- All scenarios are between separate legal entities whether related by common ownership or not.

2. A number of issues have not been dealt with at this stage. These include, for example, potential fraud and avoidance, distortion of competition, and situations involving businesses with establishments in different countries. These issues will be considered later once the fundamental concepts that emerge from the models and examples have been understood and agreed. It may well be that some of the findings of this paper will not be applicable in all situations, for example, fraud, double taxation or unintentional non-taxation.

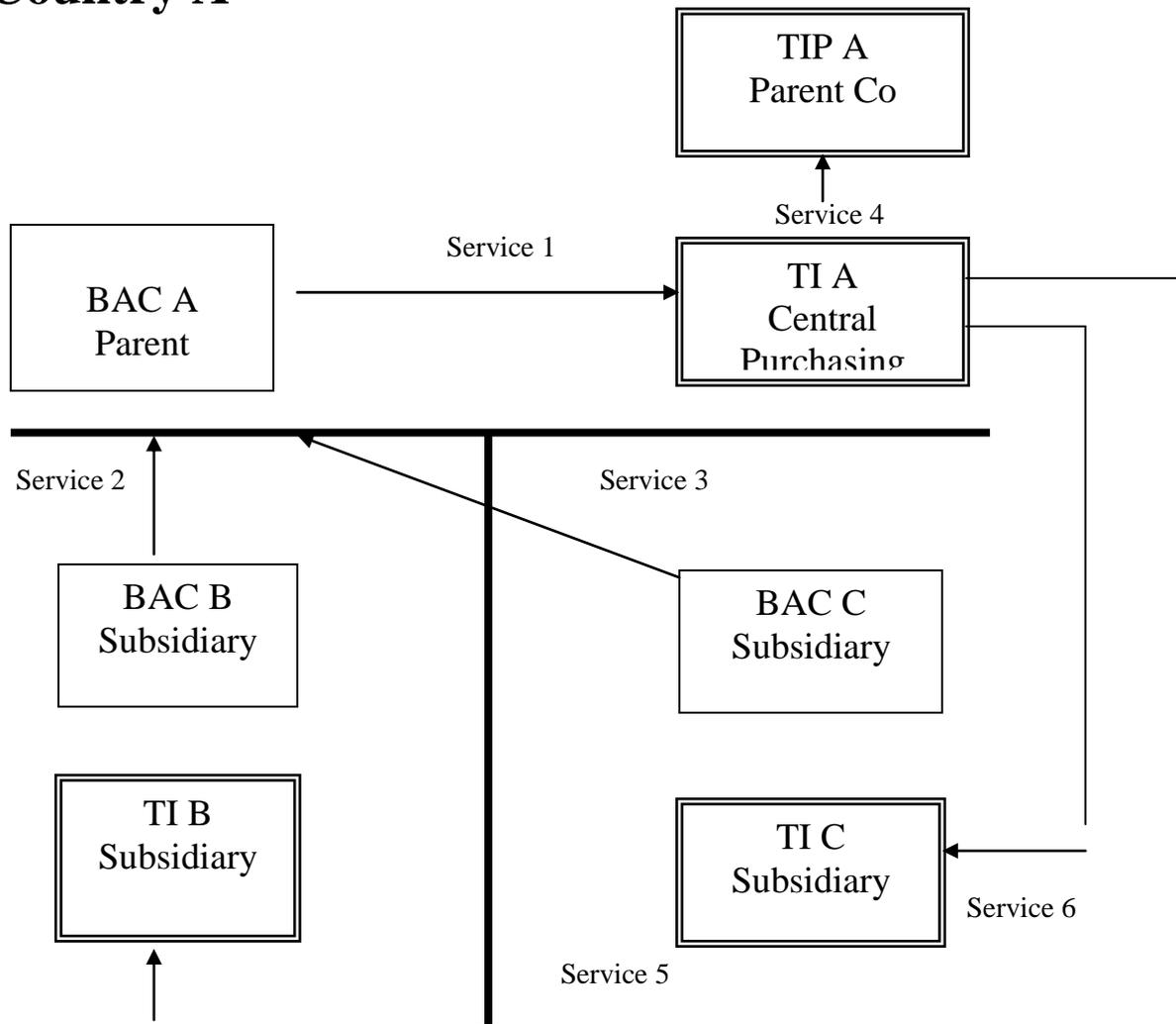
3. With increasing globalisation, international business models have developed to assist in organising supplies in the most cost efficient manner and to ensure a consistent global standard of service and delivery to a business group located in several different countries. These models are realised by different kinds of global agreements, including framework agreements (sometimes called “umbrella” agreements) and centralised procurement agreements. The examples which follow are illustrations of some of the types of global agreements that occur. The place of taxation of services provided under such agreements is determined according to the facts of each individual supply. It is recognised that other types of international agreements (e.g. regional) exist but these are not used as examples in this paper.

4. It is recognised that this paper is concerned with cross-border supplies. In order to determine whether a cross-border supply exists, it is necessary, according to the Main Rule, to determine customer location. In some cases, application of the Main Rule will result in a determination that the customer is located in the same jurisdiction as the supplier. Taxation is, therefore, subject to the laws of that jurisdiction.

**Example 1: A global agreement**

*This example illustrates the supplies that occur when a global agreement for a supply of auditing services is entered into between the parent company of the audit group and a centralised purchasing company of the group requiring audit services for other group members in various countries.*

**Country A**



**Country B**

**Country C**

5. TI A is a centralised purchasing company in country A. It belongs to a multinational company group with subsidiaries around the world, for example in country B, TI B and in country C, TI C. TIP A is the parent company, also located in country A. BAC A is a parent company in

country A belonging to a multinational auditing company group with subsidiaries around the world, for example in country B, BAC B; and in country C, BAC C.<sup>1</sup>

6. TI Group requires a global auditing service to meet legal requirements for the companies in country A and the subsidiaries in countries B and C. The global auditing service is purchased by TI A (for the whole group) which therefore concludes a centralised purchasing agreement with BAC A to supply auditing services to the whole TI Group (including TIP A, TI A, TI B and TI C). Payment will follow each business agreement.

7. The global auditing service is supplied by BAC A to TI A in return for consideration. This service includes the supply of all components of the global agreement. BAC A is able to actually perform only part of the services itself. The services to TI A and TIP A, which are located in country A, are performed directly by BAC A. However, to be able to fulfil the rest of the agreement, BAC A enters into business agreements with its two subsidiaries, BAC B and BAC C under which BAC B and BAC C supplies auditing services to BAC A. However, BAC B and BAC C physically perform the services directly to the subsidiaries of TIP A (TI B and TI C). The subsidiaries of TIP A involved, TI B and TI C, are in the same countries as the subsidiaries of BAC A involved in the transactions. TI A enters into separate business agreements with TIP A and the subsidiaries TI B and TI C under which TI A supplies auditing services to TIP A and the subsidiaries TI B and TI C.

8. There are six separate business agreements in this example, each leading to a supply of a service for consideration. BAC A is the supplier and TI A is the customer under the centralised purchase agreement (service 1). BAC B and BAC C are the suppliers and BAC A is the customer under two different business agreements (service 2 and service 3). TI A is the supplier and TIP A is the customer under a different agreement (service 4). TI A is the supplier and TI B and TI C are the customers under two different business agreements (service 5 and service 6). The place of taxation will be decided for each supply individually.

9. In accordance with the main rule, the place of taxation for the supply of service 1 between BAC A and TI A will be country A as TI A is in country A. In accordance with the main rule the place of taxation for the supply of services 2 and 3 between BAC B and BAC C as suppliers and BAC A as a customer is country A for both supplies. In accordance with the main rule the place of taxation for the supply of service 4 between TI A and TIP A will be country A as TIP A is in country A. In accordance with the main rule, the place of taxation for the supply of service 5 between TI A and TI B will be country B because country B is the country where the customer is located. In accordance with the main rule, the place of taxation for the supply of service 6 between TI A and TI C will be country C because country C is the country where the customer is located.

10. It should be noted however that, as mentioned above, the performance of these auditing services (which are supplied by BAC B and BAC C to BAC A) is rendered physically to TI B and TI C. The fact that the services are supplied to someone (BAC A and then on to TI A) different from those (TI B and TI C) to which the services are physically rendered is not relevant in this example to determine the place of taxation, as the place of taxation will still be determined by the

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<sup>1</sup> For the purposes of these examples and especially for simplicity and clarity, it is assumed that the auditing group is structured on a parent/subsidiary basis, although it is recognised that this is not normally the case in this sector.

customer location, as supported by the business agreement, and not where or to whom the services are rendered.

11. The reason for this is that, at each stage of this example, all supplies will be subject to the taxation rules in the jurisdiction where the customer is located and the services consumed according to the main rule. There is neither double taxation nor unintentional non-taxation in countries A, B and C. In particular, the tax that accrues to countries B and C reflects the consumption of the services in those countries. There is no reason to depart from the business agreements e.g. by following the interaction between BAC B and TI B or between BAC C and TI C.

12. In developing this example, care has been taken to avoid any stewardship issues that may exist with respect to TIP A. In other words TIP A, as the parent, may also be seen as deriving an element of benefit from the audit activities in countries A, B and C, for example because such audit included an additional review of financial statements under the parent company's country accounting standards, rather than only per local subsidiary country accounting standards. Stewardship issues<sup>2</sup> do not arise in example 1 due to the inclusion of service 4, where TI A supplies auditing services to TIP A. Further, any questions concerning valuation for VAT/GST purposes and the possible identification of supplies existing, other than those shown, are also ignored.

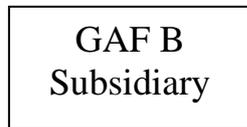
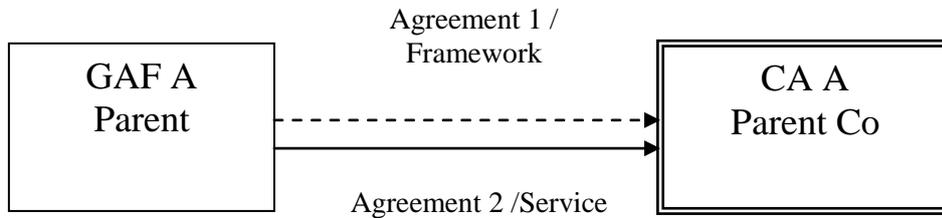
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<sup>2</sup> Stewardship expenses are broadly the costs incurred by the parent company of the group for administrative and other services provided to subsidiaries and other affiliates for the benefit of the parent, as a shareholder, rather than for the individual benefit of the subsidiary or affiliate. These costs can be incurred directly by the parent or by the subsidiary and passed on to be absorbed by the parent. Typically, these are treated as expenses which ought to be absorbed by the parent company because they must be regarded as stewardship or shareholder's expenses benefiting the shareholder or the group as whole and not a subsidiary or affiliate individually.

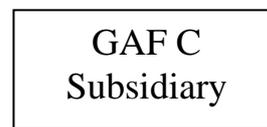
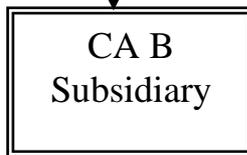
**Example 2: Alternative global agreement**

*In this example the parent company of the group requiring audit services enters into a global agreement described as a “framework agreement” with the parent company of the audit group (both in the same country) in order to provide audit services in a number of countries.<sup>3</sup>*

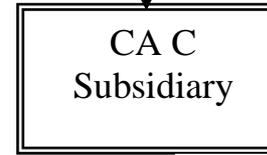
**Country A**



Agreement 3 / Service 2



Agreement 4 / Service 3



**Country B**

**Country C**

13. CA A is a parent company in country A. It belongs to a multinational company group with subsidiaries around the world, for example in country B, CA B and in country C, CA C. GAF A is a parent company in country A belonging to a multinational auditing company group with subsidiaries around the world for example, in country B, GAF B; and in country C, GAF C.

14. CA Group requires a global auditing service to meet legal requirements for the companies in country A and its subsidiaries in countries B and C. CA A concludes an agreement (i.e. a framework agreement) with GAF A (Agreement 1). The framework agreement covers definitions, obligations relating to confidentiality, warranties, due dates for payment and limitations of liability, that would only apply if and when members of GAF A and CA A enter into separate agreement referring to this framework agreement. The agreement also provides that

<sup>3</sup> The expression “framework agreement” is used solely to distinguish it from the separate business agreement for audit services to the parent trading company. This report does not attempt to define in any way what a “framework agreement” might be.

companies that are affiliated with CA A and the auditing companies that are affiliated with GAF A may enter into business agreements which will incorporate the terms of the framework agreement by reference. The agreement however does not oblige any member of CA A group or GAF A group to enter into such business agreements.

15. CA A enters into a separate business agreement with GAF A for the audit of CA A (Agreement 2); CA B enters into a business agreement with GAF B (Agreement 3); and CA C enters into a business agreement with GAF C (Agreement 4). In each of these three separate agreements (i.e. Agreements 2-4), an article is included where the parties agree to incorporate the terms included in the framework agreement (Agreement 1). Payment will follow each business agreement.

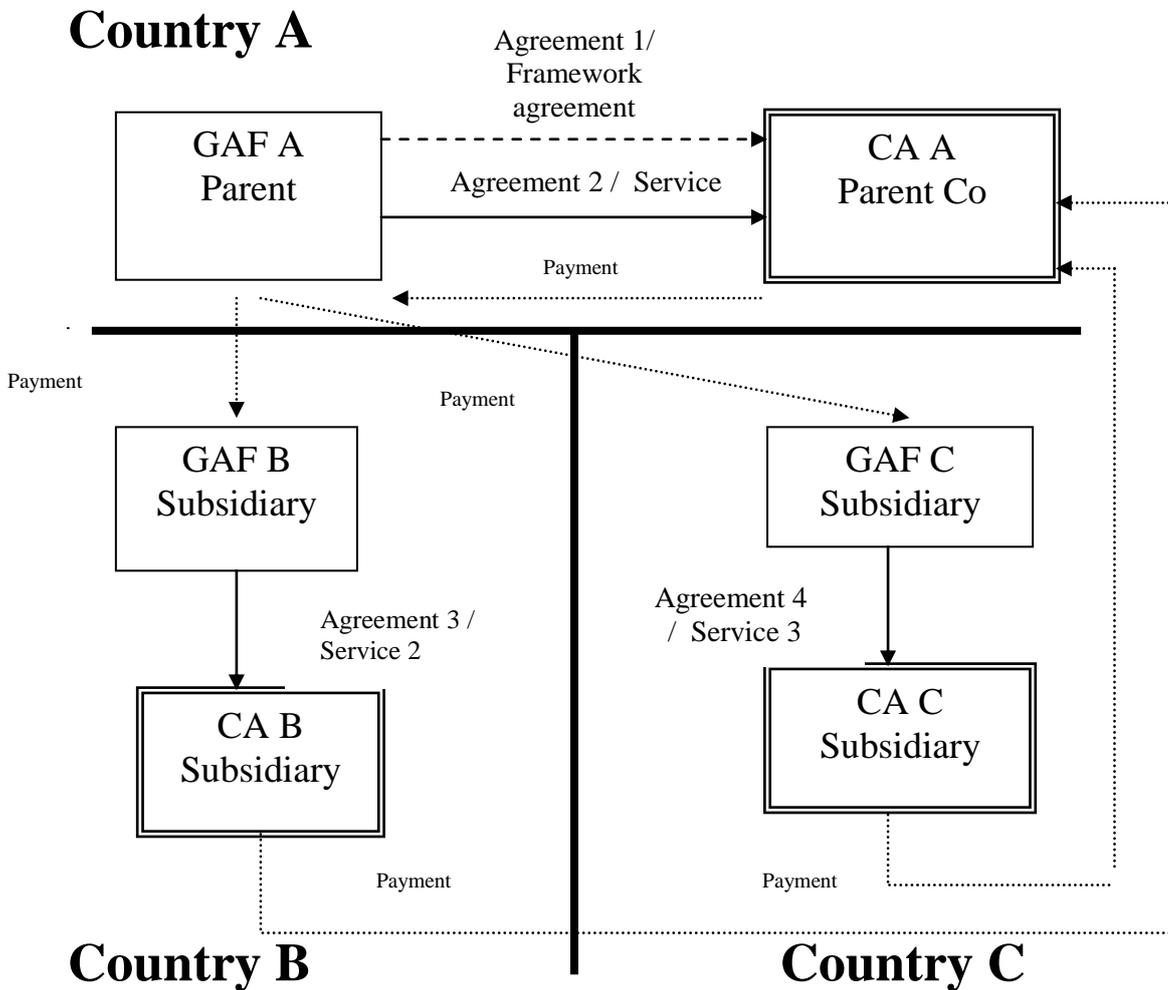
16. There are four separate business agreements in this example, only three of which lead to a supply of a service for consideration. The first agreement (Agreement 1) is not transactional, has no consideration and does not create a supply. Agreement 1 stipulates terms and conditions which only become activated when parties agree to separate business agreements as specified in the framework agreement. Under the second agreement (Agreement 2), GAF A is the supplier and CA A is the customer (Service 1). Under the third agreement (Agreement 3), GAF B is the supplier and CA B is the customer (Service 2). Under the fourth agreement (Agreement 4), GAF C is the supplier and CA C is the customer (Service 3). The place of taxation will be decided for each supply individually.

17. In accordance with the main rule, the place of taxation for the supply of service 1 between GAF A and CA A will be country A as CA A is in country A. In accordance with the main rule, the place of taxation for the supply of service 2 between GAF B and CA B will be country B as CA B is in country B. Further, and again in accordance with the main rule, the place of taxation for the supply of service 3 between GAF C and CA C will be country C as CA C is in country C.

18. All three supplies are subject to the taxation rules in the jurisdiction where the customer is located and the services consumed according to the main rule. There is neither double taxation nor unintentional non-taxation in countries A, B or C. There is no reason to depart from the business agreements. In particular, no transactions take place under the framework agreement (Agreement 1) itself in this example. Consequently, no supplies are made under that agreement and no place of taxation issue arises.

**Example 3: Alternative global agreement – different flow of payment**

*This example expands upon example 2 by introducing payment flows that are different from the flows of the services as set out in the underlying business agreement.*



19. This example is similar to example 2 except that the CA group has put in place a system for settling inter-company transactions between group members. As a result, the CA group decides to reduce the costs associated with cash disbursements by appointing CA A as the common paymaster for the group<sup>4</sup>. The Framework Agreement in this example is similar to example 2 except that it specifies that the payments for the services supplied under the locally concluded business agreements will be handled by CA A directly with GAF A for the whole CA group.

20. For the audit services supplied under the three business agreements GAF A, GAF B and GAF C will follow the general invoicing process and issue invoices respectively to CA A, CA B and CA C. For payment purposes, however, GAF A will issue a collective statement (with copies attached of the invoices issued for the services supplied) to CA A. Based on the collective

<sup>4</sup> It is recognised that, in some cases, the paymaster function could create a separate supply, or supplies, between CA A and its subsidiaries. For the purposes of this example this is not the case.

statement CA A will pay the requested amount to GAF A and will on the same day collect the respective amounts from CA B and CA C. Similarly, GAF A will transfer the respective amounts over to GAF B and GAF C on the same day it receives the payment from CA A.

21. The movements of payment are simply cash or account entries. The payment CA A makes to GAF A represents consideration for the services supplied from GAF A to CA A, from GAF B to CA B and from GAF C to CA C.

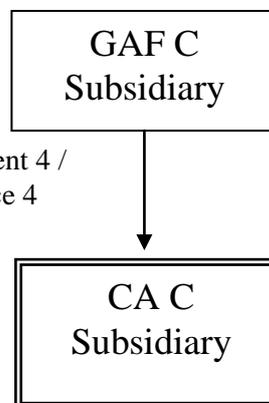
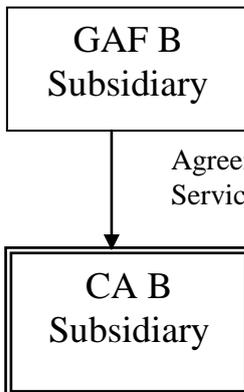
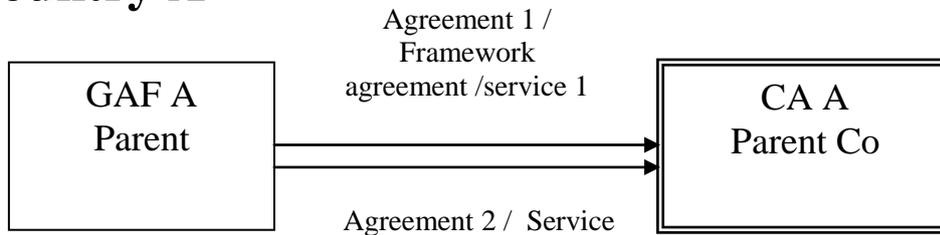
22. The conclusions reached in example 2 about the place of taxation of the supplies made under the business agreements (agreements 2, 3 and 4) remain valid. The fact that payments are transferred via CA A and GAF A has no impact on those conclusions.

23. All supplies under the business agreements are subject to the taxation rules in the jurisdiction where the customer is located according to the main rule. There is neither double nor unintentional non-taxation in countries A, B or C. There is no reason to depart from the business agreements e.g. by following the cash flows. The cash flows between the CA subsidiaries and CA A, between CA A and GAF A, and between GAF A and the GAF subsidiaries are consideration for services supplied under the business agreements but do not in themselves create additional supplies, nor alter the supplies, nor identify the customer or customer location.

**Example 4: Alternative global agreement – supply under a framework agreement**

*This example expands upon example 2 by introducing a supply under the framework agreement.*

**Country A**



**Country B**

**Country C**

24. This example is similar to example 2 except that in addition it demonstrates what happens when the parent companies conclude under the framework agreement for supplies to be made based on the terms set out in that agreement. In addition to the local supplies already considered in example 2, CA A pays a coordination fee to GAF A. The framework agreement therefore specifies that GAF A has a coordination function and coordinates with its subsidiaries, GAF B and GAF C, such that the quality, pricing and process set out in the framework agreement is correctly followed in the business agreements. This is done for the sole benefit of CA A and CA A pays a fee for this to GAF A.

25. Under the framework agreement (agreement 1), GAF A supplies a service to CA A for a consideration. In accordance with the main rule, the place of taxation for this supply (service 1) will be a local supply in country A as both companies are in country A.

26. The conclusions reached in example 2 about the place of taxation of the supplies made under the business agreements (agreements 2, 3 and 4) remain valid.

## Summary

27. Paragraph 25 of the report *Emerging Concepts for Defining Place of Taxation* set out some summary observations regarding examples of some relatively simple cross border transactions:

“The examples illustrate that, in practical terms, the result of the main rule is that the jurisdiction where the customer is located, as normally supported by the business agreement, has the taxing rights over a service or intangible supplied across international borders. This principle should be applicable in the following way:

- The place of taxation should be decided for each supply individually so that the determination of the place of taxation of a service or intangible for VAT/GST purposes will not be influenced by any subsequent supply or lack of such supply;
- This normally remains the case whether or not the two parties to a transaction are related in terms of ownership and control;
- A business in the customer’s jurisdiction which is related through common ownership to the supplier does not affect these conclusions as long as there is no supply from that business to this customer;
- Similarly, a business in the supplier’s jurisdiction which is related through common ownership to the customer does not affect these conclusions as long as there is no supply from the supplier to that business.”

28. The more complex examples of services supplied under global agreements in this paper both support and add to these observations:

- (1) Examples 1-4 involve more complex supply chains, different business structures and different global agreements. Services may be bought in by a business and re-supplied across borders for reasons unrelated to VAT/GST considerations. Nevertheless, the customer location, as supported by the business agreement, continues to give a satisfactory outcome for determining the place of taxation. In particular, the examples provide further evidence of the application of the main principle in the *Emerging Concepts* paper in that the place of taxation should be decided for each supply individually so that determination of the place of taxation of a service for VAT/GST purposes will not be influenced by any subsequent supply or lack of such supply.
- (2) Under the main rule the supplier’s physical rendering of a service to a business other than the customer under the business agreement does not in itself affect the observations above so that it is the customer location supported by the business agreement that determines the place of taxation.
- (3) The customer location, as supported by the business agreement, achieves a logical result when applied to the facts of each example. Thus, any supplies are subject to tax in the jurisdiction in which the services are consumed according to the main rule and there is neither double taxation nor unintentional non-taxation in any of the countries involved. This outcome is unaffected by the business structure, the complexity of the supply chain, the type of agreement, the country where the service is physically rendered or the direction

of the cash flows. This reinforces the use of customer location as an appropriate proxy for consumption.

29. As noted in paragraph 2 there are situations, such as potential fraud and avoidance and transactions between parts of a single legal entity, where these findings may not be appropriate. Further work will be undertaken to test these findings in such situations.

**ANNEX 1**  
**INVITATION TO COMMENT ON PLACE OF TAXATION**  
**CONTACT INFORMATION**

**Contact for follow-up:**

Name:

Organisation:

Country:

E-mail address:

Telephone:

Fax:

Please indicate whether you are responding to this questionnaire :

- As an academic or student
- As a corporate taxpayer
- On behalf of other taxpayer(s) (e.g. advisory firm, law firm, business association, etc.)
- Other (please specify)

Where you are replying on behalf of others please construe the term “you” to mean “your organisation” or “your clients” as appropriate.

Do you authorize the OECD to publish your contribution on our internet site?

- Yes
- No