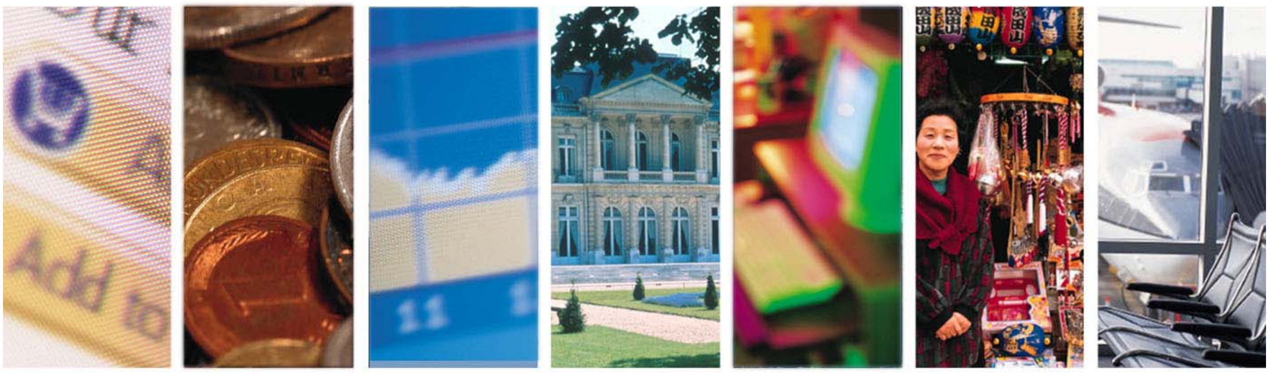
OECD

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



INTERNATIONAL VAT/GST GUIDELINES

February 2006

CTPA

CENTRE FOR TAX POLICY AND ADMINISTRATION

INTERNATIONAL VAT/GST GUIDELINES

PREFACE

1. The spread of Value Added Tax (also called Goods and Services Tax – GST) has been the most important development in taxation over the last half-century. Limited to less than ten countries in the late 1960s it has now been implemented by about 136 countries; and in these countries (including OECD member countries) it typically accounts for one-fifth of total tax revenue. The recognised capacity of VAT to raise revenue in a neutral and transparent manner drew all OECD member countries (except the United States) to adopt this broad based consumption tax. Its neutrality of principle towards international trade also made it the preferred alternative to customs duties in the context of trade liberalisation.

2. At the same time as VAT was spreading across the world, international trade in goods and services was expanding rapidly as part of globalisation developments, spurred on by deregulation, privatisation and the communications technology revolution. As a result, the interaction between value added tax systems operated by individual countries has come under greater scrutiny as potential for double taxation and unintentional non-taxation has increased.

3. When international trade was characterised largely by trade in goods, collection of taxes was generally undertaken by customs authorities, and when services were primarily traded within domestic markets, there was little need for global attention to be paid to the interaction between national consumption tax rules. That situation has changed dramatically in recent years and the absence of internationally agreed approaches, which can be traced back to that lack of need, is now leading to significant difficulties for both business and governments, particularly for the international trade in services and intangibles, and increasingly for the trade in goods.

4. Even though the question remains difficult –and sometimes controversial- for interstate trade within federations or within economically integrated areas, the destination principle (i.e. taxation in the jurisdiction of consumption by zero rating of exports and taxation of imports) is the international norm. The issues therefore arise primarily from the practical difficulty of determining, for each transaction (i.e. the sale of a good, a right or a service), the jurisdiction where consumption is deemed to take place and therefore where it should be taxed. In addition, it should be borne in mind that value added tax systems are designed to tax final consumption and as such, in most cases it is only consumers who should actually bear the tax burden. Indeed, the tax is levied, ultimately, on consumption and not on intermediate transactions between firms as tax charged on these purchases is, in principle, fully deductible. This feature gives the tax its main characteristic of neutrality in the value chain and towards international trade.

5. Nevertheless, although most countries have adopted similar principles for the operation of their value added tax system, there remain many differences in the way it is implemented, including between OECD member countries. These differences result not only from the continued existence of exemptions and special arrangements to meet specific policy objectives, but also from differences of approaches in the definition of the jurisdiction of consumption and therefore of taxation. In addition, there are a number of variations in the application of value added taxes, and other consumption taxes, including different interpretation of the same or similar concepts; different approaches to time of supply and its interaction

with place of supply; different definitions of services and intangibles and inconsistent treatment of mixed supplies.

6. Since the late 1990s, work led by the OECD's Committee on Fiscal Affairs (CFA) in cooperation with business, revealed that the current international consumption taxes environment, especially with respect to trade in services and intangibles, is creating obstacles to business activity, hindering economic growth and distorting competition. The CFA recognised that these problems, particularly those of double taxation and unintentional non-taxation, were sufficiently significant to require remedies. This situation creates increasing issues for both businesses and tax administrations themselves since local rules cannot be viewed in isolation but must be addressed internationally.

7. Businesses are increasingly confronted by distortions of competition that sometimes favour imports over local production or prevent them outsourcing activities as a means of improving their competitiveness. Multi-national businesses are confronted with laws and administrative requirements that may be contradictory from country to country. This generates undue burdens and uncertainties, in particular when they specialise or group certain functions in one particular jurisdiction, such as shared service centres, centralised sales and procurement functions, call centres, data processing and information technology support. Businesses can incur double taxation when two different jurisdictions both tax the same supply, the first one because it is the jurisdiction where the supplier is established and the second one because it is the jurisdiction where the recipient is established. In the case of leasing of goods, for example, a third jurisdiction, i.e. the jurisdiction where the goods are located, may also claim the tax. Uncertainties also arise in situations where, for example, the headquarters of a company established in one country provides supplies to customers in another country where it has a branch (force of attraction). Even if some countries implemented refund schemes of tax incurred by foreign business or registration procedures to achieve the same effect, which are intended in part to address some of the consequences of these different approaches, such schemes are, when they exist, often burdensome, especially for SMEs.

8. Tax administrations are often confronted with unintentional non-taxation that mirror the double taxation situations referred to above. Consumption taxes are normally predicated on the basis that businesses are responsible for the proper collection and remittance of the revenue. Complex, unclear or inconsistent rules across jurisdictions are difficult to manage for tax administrations and create uncertainties and high administrative burdens for business, which can lead to reduced compliance levels. In addition, such an environment may also favour tax fraud and evasion.

9. The OECD has long held a lead position in dealing with the international aspects of direct taxes. The Organisation has developed internationally recognised instruments such as the *Model Tax Convention on Income and on Capital* and the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.* Until now, no such instrument was available in the field of consumption taxes. Only the *Ottawa Framework Conditions* (1998), the *Guidelines on Consumption Taxation of Cross-Border Services and Intangible Property in the Context of E-commerce* (2001) and *Consumption Tax Guidance Series* (2003) have been published. The Committee on Fiscal Affairs therefore began work on a set of framework principles on the application of consumption taxes to the trade in international services and intangibles. These principles form the first part of the OECD VAT/GST Guidelines. These principles will be developed in order that countries (both OECD and non-OECD) can implement them in legislation. The table of contents will evolve in the light of experience and will be amended and completed over time.

TABLE OF CONTENTS

CHAPTER VII AVOIDANCE OF DOUBLE TAXATION

VII.A. Introduction

VII.B. Refund Mechanisms

VII.C. Dispute Resolution

VII.D. Exchange of Information [Mutual Cooperation]

VII.E. Possible Instruments

VII.E.1. Separate VAT Treaty

VII.E.2. New Article in MTC

VII.E.3. OECD – Council of Europe Model Convention on Mutual Administrative Assistance in Tax Matters

*

*   *

CHAPTER I

BASIC PRINCIPLES[1]

I.A. INTRODUCTION

1. There are many differences in the way value added taxes are implemented around the world and across OECD countries. Nevertheless, there are some common core features that can be described as follows:

- Value added taxes are taxes on consumption, paid, ultimately, by final consumers.
- The tax is levied on a broad base (as opposed to e.g., excise duties that cover specific products);
- In principle, business should not bear the burden of the tax itself since there are mechanisms in place that allow for a refund of the tax levied on intermediate transactions between firms.
- The system is based on tax collection in a staged process, with successive taxpayers entitled to deduct input tax on purchases and account for output tax on sales. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to its margin i.e. on the difference between the VAT paid out to suppliers and the VAT charged to customers. In general, OECD countries with value-added taxes impose the tax at all stages and normally allow immediate deduction of taxes on purchases by all but the final consumer.

2. These features give value added taxes their main economic characteristic, that of neutrality. The full right to deduction of input tax through the supply chain, with the exception of the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain and the technical means used for its delivery (stores, physical delivery, Internet).

3. Value added taxes are also neutral towards international trade according to international norms since they are destination based (even if the rule might be different for transactions made within federations or economically integrated areas). This means that exports are zero rated and imports are taxed on the same basis and with the same rate as local production. Most of the rules currently in place aim therefore at taxing consumption of goods and services within the jurisdiction where consumption takes place. Practical means implemented to this end are nevertheless diverse across countries, which can, in some instances, lead to double or involuntary non-taxation, and uncertainties for both business and tax administrations.

---

[1] Germany expressed its reservation on these principles. Luxembourg expressed its reservation on the first principle referred in paragraph 14 ("*For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption*").

4. Sales tax systems, although they work differently in practice, also set out to tax consumption of goods, and to some extent services, within the jurisdiction of consumption. To this end, their implementation also aims at keeping it neutral towards international trade. However, in most sales tax systems, businesses do incur irrecoverable sales tax and, if they subsequently export goods, there will be an element of sales tax embedded in the price.

I.B. APPLICATION TO INTERNATIONAL TRANSACTIONS

5. For the international trade in goods there is a commonly held principle that exports should be exempted and imports should be taxed. This is relatively simple to apply, although even here, complexities of globalisation mean that problems can arise. However, for the international trade in services and intangibles there are no such commonly held principles. Thus, the variations by governments in the application of consumption taxes to this increasing trade have led to obstacles to business activity and distortions of competition significant enough to justify the design of common principles. There is also a shared view, both by governments and business, that the neutrality principle described above should be kept as an objective in the design and implementation of VAT/GST Guidelines. The following principles aim mainly at ensuring that transactions are taxed only once and in a single, clearly defined jurisdiction in order to avoid uncertainties, double taxation or involuntary non-taxation.

6. The development of e-commerce in the late 1990s led governments to adopt several principles in the field of consumption taxes[2]. Although they were designed in the context of e-commerce taxation, they remain valid for the more global interaction of consumption tax systems and broadly reflect the philosophy of the existing tax rules in most countries. In addition, the Ottawa Framework Conditions specify that the taxation principles that guide governments in relation to conventional commerce should not be different than those applicable to electronic commerce. These principles can be summarized as follows:

- ***Neutrality:*** Taxation should seek to be neutral and equitable between forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

- ***Efficiency:*** Compliance costs for taxpayers and administrative costs for the tax authorities should be minimized as far as possible;

- ***Certainty and simplicity:*** The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences of a transaction, including knowing when, where and how the tax is to be accounted;

- ***Effectiveness and fairness:*** Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimized while keeping counter-acting measures proportionate to risks involved;

- ***Flexibility:*** The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments;

[2] The Ottawa Framework Conditions were endorsed by Ministers in October 1998

7. Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place and international consensus should be sought on circumstances under which supplies are held to be consumed in a jurisdiction.

8. As regards value added taxes, an additional principle can be established from the general functioning of those taxes: except where explicitly designed, i.e. when several operations are explicitly exempted (input taxed) like financial services, or excluded from the application of the value added taxes, like operations not effected for consideration, the tax burden should not lie on taxable business but on the final consumer.

I.B.1. SERVICES AND INTANGIBLES

9. The above mentioned general principles can be adapted to the cross-border trade in services and intangibles as follows, for both business to business and business to consumer transactions:

- **For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption;**

- **The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.**

10. In this context, the words "except where explicitly provided" mean that countries may legitimately place a value added tax burden on business. Indeed, this is frequently the case as the following examples illustrate:

- Where transactions made by the taxpayer are exempt because the tax base of the outputs is difficult to assess (i.e., many financial services) or for policy reasons (health care, education, culture).

- Tax legislation may also impose value added tax on businesses to secure effective taxation of final consumption. This will be the case when the taxpayer makes transactions that fall outside the scope of the tax (e.g., transactions without consideration) or the input tax relates to purchases that are not wholly used for furtherance of taxable business activity.

- Countries also provide legislation that disallows input tax recovery where explicit administrative obligations are not met (e.g., insufficient evidence to support input tax deduction).

11. For the purposes of these principles however, any such imposition of value added tax on business should be clear and explicit within the legislative framework for the tax.

12. As with many other taxes, value added taxes impose compliance costs on business. It is not the intention of these principles to suggest that compliance costs should not be borne by business, but rather that, business should not incur irrecoverable value added tax (other than within the sort of exceptions exemplified in paragraph 10).

CHAPTER III TAXATION OF SERVICES IN SPECIFIC SECTORS

III.C. Electronic Commerce

A. Guidelines on the Definition of the Place of Consumption

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 in order to prevent double taxation or unintentional non-taxation, particularly in the context of international cross-border electronic commerce. Member countries are encouraged to review existing national legislation to determine its compatibility with these Guidelines and to consider any legislative changes necessary to align such legislation with the objectives of the Guidelines. At the same time, Member countries should consider any control and enforcement measures necessary for their implementation.

Business-to-business transactions

3. 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[3] should be the jurisdiction in which the recipient has located its business presence[4].

---

[3] This will normally include a "taxable person" or an entity who is registered or is obliged to register and account for tax. This may also include another entity that is identified for tax purposes.
[4] The "business presence" is, in principle, the establishment (for example, headquarters, registered office, or a branch of the business) of the recipient to which the supply is made.

4. In certain circumstances, countries may, however, use a different criterion to determine the actual place of consumption, where the application of the approach in paragraph 3 would lead to a distortion of competition or avoidance of tax[5].

Business-to-private consumer transactions

5. 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 private recipient[6] should be the jurisdiction in which the recipient has their usual residence[7].

Application[8]

6. 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 property by non-resident vendors/suppliers that are not otherwise registered and are not required to register in the destination jurisdiction under existing mechanisms[9][10].

7. These 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.

8. The Guidelines do *not*, therefore, 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 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 [11]

---

[5] Such an approach should normally be applied only in the context of a reverse charge or self-assessment mechanism.
[6] In other words, a "non-taxable person" or an entity not registered and ***not*** obliged to register and account for tax.
[7] 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.
[8] In accordance with the Ottawa Taxation Framework Conditions, specific measures adopted in relation to the place of taxation by a group of countries that is bound by a common legal framework for their consumption tax systems may, of course, apply to transactions between those countries.
[9] While these Guidelines are not intended to apply to sub-national value-added and general consumption taxes, attention should be given to the issues presented, in the international context, relating to these taxes.
[10] 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).
[11] When such specific approaches are used, the Working Party recognises the need for further work and for international co-ordination of such arrangements to avoid double or unintentional non-taxation.

B. Recommended Approaches to the Practical Application of the Guidelines on the Definition of the Place of Consumption

Introduction

9. Three tax collection mechanisms are typically used in consumption tax systems: registration, reverse charge/self-assessment, and collection of tax by customs authorities on importation of tangible goods. Under a registration system, the vendor of goods and services registers with the tax authority and, depending on the design of the tax, either is liable to pay the tax due on the transaction to the tax authority, or collects the tax payable by the customer and remits it to the tax authority. Under the reverse charge/self-assessment system, the customer pays the tax directly to the tax authority. The third approach, collection of the tax on the importation of tangible goods by customs authorities, is common to virtually all national consumption tax systems where national borders exist for customs purposes.

10. Since registration and self-assessment/reverse charge mechanisms are currently in use in the majority of consumption tax systems, they represent a logical starting point in determining which approaches are most appropriate to apply in the context of electronic commerce transactions involving cross-border supplies of services and intangible property.

11. While emerging technology promises to assist in developing innovative approaches to tax collection, and the global nature of electronic commerce suggests that collaborative approaches between revenue authorities will become increasingly important, Member countries agree that in the short term, the two traditional approaches to tax collection remain the most promising. However, Member countries agree that their application varies depending on the type of transaction.

Recommended approaches

Business-to-business transactions

12. In the context of cross-border business-to-business (B2B) transactions (of the type referred to in the Guidelines), it is recommended that in cases where the supplying business is not registered and is not required to be registered for consumption tax in the country of the recipient business, a self-assessment or reverse charge mechanism should be applied where this type of mechanism is consistent with the overall design of the national consumption tax system.

13. In the context of B2B cross-border transactions in services and intangible property the self-assessment/reverse charge mechanism has a number of key advantages. Firstly, it can be made effective since the tax authority in the country of consumption can verify and enforce compliance. Secondly, given that it applies to the customer, the compliance burden on the vendor or provider of the service or intangible product is minimal. Finally, it reduces the revenue risks associated with the collection of tax by non-resident vendors whether or not that vendor's customers are entitled to deduct the tax or recover it through input tax credits.

14. Member countries may also wish to consider dispensing with the requirement to self-assess or reverse charge the tax in circumstances where the customer would be entitled to fully recover it through deduction or input tax credit.

Business-to-consumer transactions

15. Effective tax collection in respect of business-to-consumer (B2C) cross-border transactions of services and intangible property presents particular challenges. Member countries recognise that no single option, of those examined as part of the international debate, is without significant difficulties. In the medium term, technology-based options offer much potential to support new methods of tax collection. Member countries are expressly committed to further detailed examination of this potential to agree on how it can best be supported and developed.

16. In the interim, where countries consider it necessary, for example because of the potential for distortion of competition or significant present or future revenue loss, a registration system (where consistent with the overall design of the national consumption tax system) should be considered to ensure the collection of tax on B2C transactions.

17. Where countries feel it appropriate to put into effect a registration system in respect of non-resident vendors of services and intangible property not currently registered and not required to be registered for that country's tax, it is recommended that a number of considerations be taken into account. Firstly, consistent with the effective and efficient collection of tax, countries should ensure that the potential compliance burden is minimised. For example, countries may wish to consider registration regimes that include simplified registration requirements for non-resident suppliers (including electronic registration and declaration procedures), possibly combined with limitations on the recovery of input tax in order to reduce risks to the tax authority. Secondly, countries should seek to apply registration thresholds in a non-discriminatory manner. Finally, Member countries should consider appropriate control and enforcement measures to ensure compliance, and recognise, in this context, the need for enhanced international administrative co-operation.