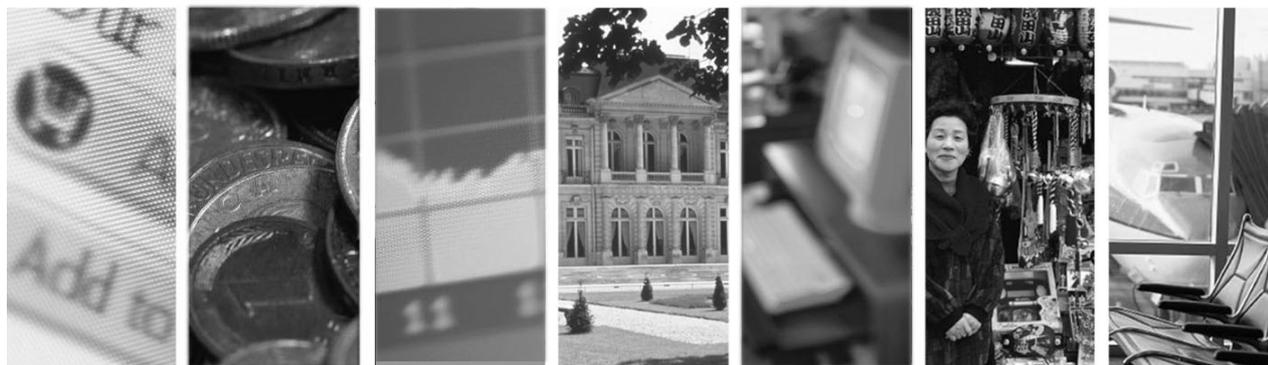




ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



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CENTRE FOR TAX POLICY AND ADMINISTRATION

Chapter II

APPLICATION OF PLACE OF CONSUMPTION PRINCIPLES

1. INTRODUCTION

1. Value added taxes (VAT)¹ are designed in such a way that they primarily tax household consumption.² Businesses are required to collect these taxes. For domestic supplies, suppliers generally charge the tax, at the appropriate rate, to their customers, irrespective of the tax status of those customers. An essential requirement within the system is that obtaining goods, services and intangibles^{3 4} originating domestically should not provide an advantage, or a disadvantage, over obtaining the same goods, services or intangibles originating in another jurisdiction. Thus, there is a need for neutrality.

2. VAT neutrality in international trade (referred to as “international neutrality”) is achieved by use of the “*destination principle*” (“destination” and “origin” are used in a legal, rather than an economic, sense). Under this principle, goods, services and intangibles are zero-rated when leaving one jurisdiction and are taxed at importation in another jurisdiction. In this way, it makes no difference whether goods, services or intangibles are obtained domestically or from abroad; the domestic VAT rate will always apply. On the other hand, if tax were to accrue to the jurisdiction in which the supplier is located according to the “*origin principle*”, then there would be very real risks of competitive distortion and increased compliance costs. The origin principle, being the opposite of the destination principle, provides that tax accrues to the jurisdiction from which a supply is made. Thus exports would be taxed at the rate applicable in the jurisdiction of exportation and imports would not be taxed. Goods, services and intangibles purchased from a jurisdiction without a VAT or with a low VAT rate would therefore be at a significant advantage to goods, services and intangibles purchased from jurisdictions that have higher rates. As VAT is a tax on domestic consumption, there would be serious competitive distortions. Under such an origin principle, the only way to neutralise these distortions would be to put in place major

¹ Some jurisdictions cite their form of value added tax as a “*Goods and Services Tax*” (GST). For ease of reading, all value added taxes will be referred to as “VAT”.

² There are examples, such as exemptions and input tax blocks on specific items, which lead to the burden of the tax falling on businesses rather than on household consumption.

³ It is recognised that some jurisdictions have a residual definition of services that includes “*intangibles*” whereas some jurisdictions regard “*intangibles*” as a separate category. For the purpose of this guidance, “*intangibles*” may be described as encompassing identifiable non-monetary assets that cannot be seen, touched or physically measured.

⁴ There may not always be consistency between countries when categorising goods, services or intangibles. For example, some countries regard hire of goods as a supply of a service whereas others regard it as a supply of goods. If necessary, this issue will be considered later.

systems that would allow the customers to reclaim the VAT incurred by claiming it from the tax administration in the supplier's jurisdiction. This would be extremely onerous for businesses and tax administrations, could open up opportunities for fraud and create greater complexity in dealing with businesses that do not have full rights to input tax deduction. Thus, applying the tax regulations of the jurisdiction of consumption of services and intangibles provides a more "*neutral*" solution and ensures it is domestic consumption that is taxed.

3. It is important that there be international consistency in the application of the destination principle. A supply from a jurisdiction that operates an origin principle to a jurisdiction that operates a destination principle would result in double taxation. A reverse of this scenario would result in double non-taxation.

4. For goods, this international neutrality is achieved in a relatively simple way. Exports are relieved from VAT and the VAT incurred on their production and distribution prior to export is credited through the usual system of input tax deduction within the supply chain. The final exporter receives a credit for the input tax incurred on their purchase but the sale of those goods to the customer in the second jurisdiction is free of VAT.⁵ When the goods enter the importing jurisdiction they are subject to the VAT regulations in that jurisdiction and any tax is imposed at the appropriate rate under that jurisdiction's VAT regime. This ensures that imported goods are subject to the same tax regime as domestically produced goods.

5. Applying this international neutrality to supplies of services and intangible products, however, is more difficult. The nature of services and intangibles is such that they cannot physically be seen as "*exported*" from one jurisdiction and "*imported*" into another jurisdiction. This lack of tangibility means that there are no customs controls that can confirm their exportation and no customs controls to impose the VAT at importation. Thus, special rules have to be developed for determining the jurisdiction of taxation for international supplies of services and intangibles that ensure that:

- international neutrality is maintained;
- compliance by businesses involved in these supplies is kept as simple as possible;
- clarity and certainty are provided for both business and tax administrations;
- the costs involved in compliance and administering the tax are minimal; and
- barriers to fraud and other abuses are sufficiently robust.

6. In applying the principles that ensure neutrality (the destination principle), it may be necessary in certain circumstances to apply different approaches to international supplies from business to

⁵ "[F]ree of VAT" may be termed zero-rated, exempt with credit, outside the scope of VAT or some other local terminology. Whatever the description used, the effect should be the same – no VAT is added by the supplier but the supplier is entitled to input tax credits, to the extent that the jurisdiction allows, in respect of such supplies.

business⁶ than to international supplies from business to consumers. This may be particularly relevant for international supplies of services and intangibles. These Guidelines therefore provide separate consideration of business-to-business and business-to-consumer supplies of goods and then likewise provide separate consideration of business-to-business and business-to-consumer supplies of services and intangibles.

7. These Guidelines attempt to provide governments and business with a set of approaches to taxing international supplies that address the matters outlined in paragraph 5. However, it is recognised that there will always be difficult areas and other Sections of this Chapter identify certain types of supplies and certain sectors that require separate consideration. Although the result should always ensure the principle of neutrality, these sectors and types of supply may need specific approaches to ensure this outcome.

⁶ For the purposes of this guidance, “*business-to-business supplies*” should be understood as supplies where both supplier and customer are entities (either legal or natural persons) that are recognised as “*businesses*” for VAT purposes in national law. Business-to-consumer supplies will be considered later.

2. APPLICATION TO INTERNATIONAL TRADE IN GOODS

2.1. Business-to-Business Supplies

2.2. Business-to-Consumer Supplies

This section to be written later.

3. APPLICATION TO INTERNATIONAL TRADE IN SERVICES AND INTANGIBLES

3.1. Business-to-Business Supplies

In this draft a number of important assumptions are made:

- All supplies are business-to-business (business-to-consumer supplies will be considered later).
- All supplies are legitimate and with economic substance. Issues connected with tax avoidance or artificial tax minimisation will be covered later.
- All supplies are between separate legal entities with single locations only. Issues concerning supplies involving entities with multiple locations will be dealt with later.

Nothing in this section pre-empts any future approaches to the guidance on supplies involving those multiple location entities.

Readers are therefore requested to bear these significant caveats in mind.

3.1.1. Introduction

Guideline 1

The OECD has adopted the following Guideline:

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

1. The OECD's Committee on Fiscal Affairs has approved the principle that, for services and intangibles traded internationally,⁷ taxation should be subject to the rules of the jurisdiction of consumption.⁸ This is primarily to maintain neutrality within the VAT system as it applies to international trade. Where a supplier supplies an international service or intangible, it will be free of VAT within the

⁷ For the purposes of this section, "*internationally traded services and intangibles*" normally results from the supplier and the customer being located in different jurisdictions. There may be other situations involving "*internationally traded services and intangibles*" where both the supplier and the customer are located in the same jurisdiction. These will be considered later.

⁸ Although VAT primarily taxes household consumption, the multi-stage nature of the tax requires that each supply has to be subject to the rules of the relevant jurisdiction. Thus, for the purpose of this guidance, "*consumption*" refers to the use of the supply of services or intangibles at each stage rather than "*consumption*" in the economic sense.

supplier's own jurisdiction and the jurisdiction where the consumption is deemed to occur will replicate, insofar as this is possible, the system for goods by requiring that any VAT due is charged at "*importation*". This ensures that services and intangibles supplied across borders are taxed according to the rules of the customer's jurisdiction irrespective of where they are obtained, thus creating a level playing field. Businesses acquiring such services are therefore driven by economic, rather than tax, considerations.

2. Determining a pure "*place of consumption*" is often difficult, particularly with regard to services and intangibles. To take an example, a person in Jurisdiction X may contact a company for the development of software in Jurisdiction A, download the newly developed software to a laptop computer in Jurisdiction B and use it at, for example, a business conference in Jurisdiction C. In these circumstances, a case could be made for determining that consumption takes place in whatever jurisdiction the software is accessed and used. However, this would be impossible to administer. In most cases it would be difficult for a business to track usage of services in this way and difficult for a tax administration to know where the service was used. Even if the usage could be tracked, it would again, be difficult to place a monetary value on it in order to determine an amount of tax due and the compliance burdens on business and tax administrations would be unreasonable. In order to overcome the difficulties inherent in applying "*pure consumption*" tests, VATs use proxies to determine where consumption occurs and thus which jurisdiction has the right to tax.

3.1.2. Proxies to Determine Jurisdiction of Consumption

Guideline 2:

For the application of Guideline 1, the OECD has adopted the following Guideline:

For business-to-business supplies, the jurisdiction in which the customer is located has the taxing rights over internationally traded services or intangibles.

3. By and large, when a business buys in a service or an intangible from another jurisdiction, it does so for the purposes of its business operations. As such, the jurisdiction of the customer's location can stand as the appropriate proxy for the jurisdiction of consumption as it achieves the objective of neutrality. This is the jurisdiction where the customer has located its permanent business presence⁹.

4. This proxy is referred to in these Guidelines as the "*Main Rule*". According to this Main Rule, the jurisdiction where the customer is located has the taxing rights over a service or intangible supplied across international borders. At the same time, the supplier makes the supply free of VAT in its jurisdiction but retains the right to full input tax credit (subject to clearly legislated exceptions in that jurisdiction) on inputs related to making such international supplies. Only in specified or exceptional circumstances, as set out elsewhere in these Guidelines,¹⁰ should the place of taxation vary from the Main Rule. Determining the jurisdiction of a customer's location may not always be straightforward and this section sets out how such determinations should be made.

Determining Customer Location

Guideline 3:

For the application of Guideline 2, the OECD has adopted the following Guideline:

The identity of the customer is normally determined by reference to the business agreement.

5. Under Guideline 3, the identity of the customer is "*normally determined by reference to the business agreement*" as it is expected that business agreements reflect the underlying supply.¹¹ Since this Guideline draft is made under the assumption that all supplies are between separate legal entities with single locations only, the location of the customer will be known once the identity of the customer is determined. The business agreement is thus an important element of that Guideline in that it will assist the supplier, the customer and tax administrations in identifying the nature of the supply and the identity

⁹ "*Permanent business presence*" will be considered later.

¹⁰ Work on these exceptions is currently under way.

¹¹ For the purposes of this guidance, a supply of services or intangibles for VAT purposes (hereafter a "*supply*") takes place where one party to a business agreement does something, gives something or refrains from doing something to or for another party, normally in exchange for consideration.

of the parties to the supply. For these reasons, it is appropriate to first describe “*business agreement*” for the purposes of these Guidelines and explain how tax administrations and businesses may approach this.

Box 1

Business Agreement

Business agreements consist of the elements that identify the parties to a supply and the rights and obligations with respect to that supply.¹² They are generally based on mutual understanding.¹³

6. The term “*business agreement*” has been adopted because it is a general concept, rather than a term with a technical meaning, and it is not specific to any particular jurisdiction. In particular, it is not restricted to a contract (whether written or in some other format) and is therefore wide in its application, as explained below.

7. In order to determine the place of taxation under the Main Rule, it is necessary to demonstrate the nature of the supply as well as the identity of the supplier and the customer.

8. Relevant elements of the business agreement come in many forms and include, for example, general correspondence, service level agreements, purchase orders, invoices, payment instruments and receipts. Legislation and business practices in OECD member jurisdictions and beyond invariably differ and generally not for tax reasons. They may differ in respect of national laws concerning contract issues and other commercial requirements. They may also differ between different industry sectors. It is, therefore, neither possible nor desirable to draw up a prescriptive or exhaustive list of items that must be present. Rather, these Guidelines simply suggest sources of information that would help both tax administrations and business.

9. In many cases, particularly those in which significant sums of money are involved or where there are complex matters beyond a straightforward supply, it is likely that the parties to a business agreement will draw up legally enforceable contracts. These contracts will normally specify the parties to the business agreement and set out their respective rights and obligations. However, contracts in themselves should not be seen as the only relevant elements.

10. A business agreement need not be confined to written material. In certain sectors, relevant elements may be found in the form of audio recordings of telephone conversations leading to conclusions of agreements to supply or receive services and/or rights. They may also be found in electronic form such

¹² Agreements that do not lead to supplies for tax purposes are not regarded on their own as “*business agreements*” for the purposes of these Guidelines.

¹³ It is recognised, however, that on occasion supplies may occur without a mutual understanding, e.g., a court order that imposes obligations on one or more parties. In such cases the “*imposed*” agreement should nevertheless be considered as a “*business agreement*”.

as e-mails and on-line ordering records, payment and similar material and formats that are likely to emerge as new technologies develop.

11. It is recognised that business agreements are often not concluded in isolation. Consequently other agreements, including those not regarded as business agreements (e.g. agreements that do not involve a supply),¹⁴ may provide the context of the supplies made under a particular business agreement. These other agreements may therefore form a part of the relevant elements of that business agreement.

12. In the light of the previous paragraphs, the business agreement in force at the time the supply is made is the agreement that governs the implementation of the Main Rule.

13. To ease burdens in practice for both tax administrations and business, it is recommended that member jurisdictions take into account the application of Guidelines 2 and 3 in a way consistent with paragraphs 3-12 above. Wherever possible, tax administrations should communicate these approaches and relevant national laws as clearly and as widely as possible.

¹⁴ An illustration of this is the Centralised Purchasing Agreement in Example 3 and Agreement 1 in Examples 4 and 5 in the Annex.

3.1.3. Applying the Main Rule – Legal Entities¹⁵ with Single Locations

14. In the following sub-sections, the businesses to which the Main Rule applies are assumed to be separate legal entities, whether related by common ownership or not.

15. For the purposes of this section it is assumed that the supplier and customer (legal entities with single locations) are located solely in their respective jurisdictions and have no business presence elsewhere.

16. As noted in paragraph 3 above, the place of the customer's location acts as a proxy for the jurisdiction of consumption and is referred to as the Main Rule. The result of applying the Main Rule is that the jurisdiction where the customer is located has the taxing rights over a service or intangible supplied across international borders.

17. In order to apply the Main Rule satisfactorily, this guidance considers its application from the perspectives of the supplier, customer and tax administrations. Although the result remains the same – taxation at the place of the customer – the actions of all three need to be consistent with the Guideline. Examples 1 and 2 in the Annex provide relatively straightforward illustrations of how the Main Rule operates. Paragraphs 23, 26 and 31 expand on Examples 3, 4 and 5 illustrating how the Main Rule is applied in more complex situations.

Applying the Main Rule – the Supplier¹⁶

18. In a business-to-business environment, it is reasonable to assume that suppliers will normally have developed a relationship with their customers. This will be particularly so in cases where supplies of services or intangibles are made on an on-going basis or in cases where one supply is made and the value of that supply is significant enough to warrant development of business agreements such as contracts. However, it is recognised that situations can arise where there is little, if any, relationship. For example, businesses may make supplies to other businesses for low value amounts, particularly if such supplies are made electronically.

19. The principal effect of the Main Rule on suppliers is that they need to identify and be able to demonstrate who their customer is in order to make the supply free of VAT because the customer is located outside the supplier's jurisdiction. Once satisfied that the customer is a business and is located in another jurisdiction, the supplier makes that supply free of VAT as, under the Main Rule, the taxing rights for that supply are in the jurisdiction of the customer's location.

20. In many cases this will be straightforward and can be determined by reference to the business agreement including the elements considered in paragraph 8 et seq. The nature of the service or

¹⁵ Legal entities can include natural persons and non-commercial institutions such as governments, non-profit organisations and other institutions. The key point is that such entities, or certain of their activities, are recognised as "*businesses*" for VAT purposes in national law.

¹⁶ For the purposes of this guidance, the supplier is the person that has the obligation to provide a supply.

intangible being supplied and the language used in any supporting documentation may also contribute to verifying the international and business nature of the supply.

21. To avoid unnecessary burdens on suppliers, it is recommended that the customer be liable to account for any tax due. This can be achieved through the reverse-charge mechanism (sometimes referred to as “*tax shift*” or “*self-assessment*”) where that is consistent with the overall design of the national consumption tax system¹⁷. Accordingly, the supplier should not be required to be identified for VAT or account for tax in the customer’s jurisdiction.

22. There will be occasions when the supplier and customer are related through some form of common ownership, management or control. As noted above, provided the supplier and customer are separate legal entities the Main Rule still applies and does not affect the approaches set out above. Provided that the supplies are bona fide and not arranged in such a way that avoids or artificially minimises VAT, the Main Rule applies.

23. Applying the Main Rule will not therefore be influenced by the circumstance that the supplier (a) supplies a customer who supplies onwards the services to a third party,¹⁸ (b) renders¹⁹ the services to a third party that is not the customer under the business agreement or (c) is paid by a third party that is not the customer under the business agreement:²⁰

(a) The customer supplies onwards the services or intangibles to a third party business located in the jurisdiction of the supplier:

It is common for multinational businesses to centralise certain procurement activities in one jurisdiction in order to obtain the economic benefits of single large contracts as opposed to multiple lower value agreements. These are generally referred to as “*global*” agreements. The central procurement company then supplies onwards the supplies or parts of the supplies to the various associated businesses around the world.

¹⁷ For the purposes of this guidance, the “*reverse-charge mechanism*” is a tax mechanism that switches the liability to pay the tax from the supplier to the customer. Some jurisdictions do not require the customer to account for the tax under the reverse-charge mechanism when entitled to full input tax credit. This should be read as a qualification in the discussion of reverse charge in later paragraphs. The application of the reverse-charge will be considered elsewhere in these Guidelines.

¹⁸ For the purposes of this guidance, the third party is an entity recognised as a “*business*”. “*Third party*” refers to a party other than the supplier or the customer and has no correlation to its understood meaning for direct taxes.

¹⁹ In this context, the word “*renders*” is used to describe a supply under a business agreement between the supplier and the customer but where the supply is actually received by a third party. This might best be illustrated by the example of a person (C) ordering flowers to be sent to another person (R). C enters into a business agreement with the florist (F) and F delivers (renders) the flowers to R. But the supply is made between F and C. (It is recognised that this situation concerns what is typically a business-to-consumer supply of goods but is included here to emphasise the point in a way that is easily recognised and understood.)

²⁰ Situations involving avoidance will be dealt with later on.

The onward supply of those services to associated businesses will be covered by separate business agreements entered into between the central procurement company and each of the associated businesses. If the associated businesses are the customers under those business agreements, they will account for any VAT due under the Main Rule using the reverse-charge at the rate applicable in their jurisdictions.

The procurement company may well supply a business located in the same jurisdiction as the original supplier (see Annex – Example 3). When applying the Main Rule, 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 purposes will not be influenced by any subsequent supply or lack of such supply. The supplier should accordingly determine the identity of the customer by reference to the relevant business agreement. Where the customer is located in another jurisdiction, the supplier is entitled to make the supply free of VAT. The fact that the customer subsequently supplies the services or intangibles onwards is not, in itself, relevant, even where the third party is located in the jurisdiction of the supplier.

(b) The supplier renders the services or intangibles to a third party business different from the customer:

Further to the circumstances explained at (a), the supplier may also be required under the terms of the business agreement to render the service or intangible to a third party (see Annex – Example 3). As long as this is done as part of a bona fide supply, the customer remains the customer identified in the business agreement and it is this customer's location that determines the place of taxation. The mere rendering of the supply to a third party does not, in itself, affect that outcome. Accordingly, the Main Rule should be applied in such a way that the supplier makes a supply free of VAT to an overseas customer even if the third party is located in the same jurisdiction as the supplier. This does not, of course, prevent the VAT on the onward supply from the customer to the third party located in the supplier's country being subject to the tax rules of that country.

(c) The supplier is paid by a third party business that is not the customer under the business agreement:

Particular care may be required where payment flows differ from the flows of services. Typically, a customer pays a supplier for a service or intangible supplied under a business agreement. However, there may be other circumstances where another party may pay for that supply. For instance, it is common for multinational groups of businesses to reduce costs by appointing a company within a group to be the "*paymaster*"²¹ responsible for payments under the relevant agreement to pay for services received. In such cases, services supplied by the supplier or the supplier's overseas subsidiaries to overseas customers may be paid for by the customer's parent business located in the supplier's jurisdiction. Supplies may not be made to the parent business (See Annex – Example 5). When applying the Main Rule, the place of taxation should be decided for each supply individually. The direction of the payment flows and the identity and location of

²¹ This company may be referred to as a "*paymaster*", "*cash clearing agent*", "*billing agent*" or some other such term. This guidance uses the term "*paymaster*".

the payer are not, in themselves, relevant. The payment flows are consideration for the supplies under the relevant business agreements but do not, in themselves, create additional supplies, nor alter the supplies, nor identify the customer or customer location. Accordingly, the supplier makes the supply to the customer identified in the relevant business agreement and the place of taxation is that customer's location. The supplier is therefore entitled to make a supply free of VAT to an overseas customer even if that supply is paid by a third party located in the same jurisdiction as the supplier.

Applying the Main Rule – the Customer²²

24. As stated in paragraph 21, the customer should be liable to account for any tax due under the reverse-charge mechanism where that is consistent with the overall design of the national VAT tax system. Under this procedure, the customer is typically required to declare the VAT due on the supply received from the overseas supplier as output tax on the relevant VAT return. The rate to be applied is the rate applicable in the customer's jurisdiction. The customer is then entitled to input tax deduction to the extent allowed under the rules of its jurisdiction.

25. If the customer is entitled to full input tax deduction on the relevant supply, it may be that local VAT legislation does not require declaration of the output tax under the reverse-charge mechanism. This is an option provided in some jurisdictions and businesses in this position should ensure that they are aware of their jurisdiction's requirements in this respect. Similarly, some jurisdictions may employ a type of VAT that does not require application of a reverse-charge as it would not suit the nature of the tax as applied. Businesses importing services and intangibles from an overseas supplier should ensure that they are familiar with their domestic legislation and administrative practices.

26. The customer is obliged to pay any tax due on the supply under the reverse-charge mechanism where that is consistent with the overall design of the national VAT tax system. The customer should be liable to pay even where (a) the customer supplies onwards the services or intangibles to a third party (b) the service or intangible is not rendered to the customer or (c) the customer does not pay for the supply:

(a) The customer supplies onwards the services or intangibles to a third party business:

As stated in paragraph 23(a), it may be that the customer supplies onwards the services and intangibles from the overseas supplier as separate supplies (e.g. within a "global" agreement). Provided such onward supplies are bona fide and are not made as part of any arrangements designed to artificially minimise or eliminate VAT, the place of taxation should be decided for each supply individually and the original international supply is not affected (see Annex – Example 3). The Main Rule continues to be applied. It is likely that the customer when supplying onwards the supplies or parts of the supplies to associated businesses will have entered into business agreements with those businesses. Each of those associated businesses that are identified as the customers of the original customer under the business agreements will have to account for any VAT due under the reverse-charge at the rate applicable in their jurisdictions.

²² For the purposes of this guidance, the customer is the person that has the right to the supply from the supplier, notwithstanding whether the supply is actually rendered to that customer or another party or the payment is made by that customer or another party.

(b) The service or intangible is not rendered to the customer:

As described in paragraph 23(b) above, the customer may, under the terms of the relevant business agreement, require that the service or intangible be rendered to a third party. Even if that third party is located in a different jurisdiction from that of the customer identified in the business agreement, the customer retains the liability to account for any tax on that supply (see Annex – Example 3).

(c) The customer does not pay for the supply:

As described in paragraph 23(c) above, multinational business groups may appoint a group member to act as paymaster for services or intangibles supplied to the group (i.e. a “paymaster” agreement). Consequently, the customer is not the party who pays for the supply under the business agreement. In such situations the direction of the payment flows and the identity and location of the payer are not, in themselves, relevant. The supply is to the customer identified in the relevant business agreement and the place of taxation is that customer’s location (see Annex – Example 5).

Applying the Main Rule – Tax Administrations

27. The growth in international supplies of services and intangibles has led to increased complexity for tax administrations as well as businesses. The intangible nature of many services is such that the comparative simplicity for goods (exports relieved, imports taxed) cannot be replicated with respect to services and intangibles. It is, therefore, important that tax administrations make it clear to both businesses and to staff responsible for carrying out compliance checks and audits what the rules are in their own jurisdiction and that they should be applied according to the facts of each individual supply.

28. Under the Main Rule supplies of services and intangibles are subject to tax according to the rules of the jurisdiction where the customer is located. This means that a supplier of international business-to-business services and intangibles makes such supplies free of VAT. As stated in paragraph 19, the tax administration of the supplier may therefore require the supplier to produce evidence that the customer is a business and that this business is located in another jurisdiction. To minimise compliance burdens on the supplier, tax administrations are encouraged to provide businesses with clear guidance on the evidence they require.

29. Equally, as stated in paragraphs 21 and 26, the customer accounts for any VAT due to its local tax administration under the reverse-charge mechanism where that is consistent with the overall design of the national VAT system. Tax administrations are encouraged to make businesses aware of the need to account for any tax on “imported” services and intangibles from their suppliers in other jurisdictions. The normal domestic rate applicable to the nature of the service or intangible involved should be applied. If the customer is entitled to full input tax credit in respect of this supply, it may be that local VAT legislation does not require the reverse-charge to be declared on the local VAT return. In such cases tax

administrations are encouraged to publicise this to business. Jurisdictions that require this declaration should likewise make it clear that tax is required to be accounted for in this way.²³

30. The reverse-charge mechanism has a number of key advantages. Firstly, the tax authority in the jurisdiction of consumption can verify and ensure compliance since that authority has jurisdiction over the customer. Secondly, the compliance burden is largely shifted from the supplier to the customer and is minimised since the customer has full access to the details of the supply. Thirdly, the administration costs for the tax authority are also low because the supplier is not required to meet tax obligations in the customer's jurisdiction (e.g. VAT identification, audits, which would otherwise have to be administered, translation and language barriers, etc.). Finally, it reduces the revenue risks associated with the collection of tax by non-resident suppliers, whether or not that supplier's customers are entitled to deduct the input tax.

31. The determination of the place of taxation of a service or intangible for VAT purposes should be decided for each supply individually. It will, therefore, not be influenced by (a) any subsequent onward supply or lack of such supply, (b) the mere rendering of the service or intangible to a third party business other than the customer or (c) by the direction of the payment flows and the identity and location of the payer:

(a) The determination of place of taxation should not be influenced by any onward supply:

As stated in paragraphs 23(a) and 26(a), businesses with associated separate legal entities in other jurisdictions may supply onwards the services or intangibles they have bought in within a "global" agreement from overseas to other related companies. These supplies should be subject to the normal VAT rules, including the Main Rule in respect of international services and intangibles (see Annex – Example 3). Accordingly, it is recommended that:

- **the tax administration in the supplier's jurisdiction** allows the supplier to make a supply free of VAT, providing the supplier can identify the customer and demonstrate that the customer is located overseas.
- **the tax administration in the customer's jurisdiction** ensures that the customer accounts for any tax due on the supply from the overseas supplier, using the reverse-charge mechanism.

(b) The determination of the place of taxation should not be influenced by the rendering of the service or intangible to a third party business other than the customer:

As stated in paragraph 23(b) and 26(b), even if the service or much of the service (or intangible) is not rendered in the jurisdiction of the customer but into another jurisdiction such as, for instance, the jurisdiction of the supplier or in a third party's jurisdiction, the Main Rule is not overridden (see Annex – Example 3). The customer's jurisdiction remains the jurisdiction with the taxing rights as long as such on-supplies are bona fide and are not made as part of any

²³ In cases where a customer omits to account properly for such reverse-charge, but is still, nevertheless, entitled to full input tax deduction in respect of that supply, it is recommended that any penalties that might be applied should be proportionate and linked to the gravity of the failure made, where the gravity of the failure is a consideration, bearing in mind there is no net tax loss to the revenue.

arrangements designed to artificially minimise or eliminate VAT. For example, an accountancy firm may have entered into a business agreement with a customer located in another jurisdiction but may perform much of the work in its own jurisdiction and also supply its services to a third party. This does not, in itself, prevent the place of taxation from being the customer's location. Accordingly it is recommended that:

- **the tax administration in the supplier's jurisdiction** does not seek tax from the supplier where that supplier is merely rendering the service or intangible there, but allows it to make a supply free of VAT to the overseas customer identified in the business agreement.
- **the tax administration in the customer's jurisdiction** ensures that the customer accounts for any tax due on the supply from the overseas supplier, using the reverse-charge mechanism, even if the service or intangible was originally rendered by a local third party.

(c) The determination of the place of taxation should not be influenced by the direction of the payment flows and the identity and location of the payer:

Paragraph 23(c) and 26(c) above recognise that there may be situations where another party pays for the supply to the customer in the business agreement (see Annex – Example 5). That third party is usually referred to in multinational groups as the group “*paymaster*” and may not be supplied with any service or intangible itself. Irrespective of where that third party is located, the service or intangible is supplied to the customer identified in the relevant business agreement and the taxing rights belong to the jurisdiction in which that customer is located. Accordingly it is recommended that:

- **the tax administration in the supplier's jurisdiction** does not seek tax from the supplier merely because the paymaster third party is located there, but allows it to make the supply free of VAT to the overseas customer identified in the business agreement.
- **the tax administration in the customer's jurisdiction** ensures that the customer accounts for any tax due on the supply from the overseas supplier, using the reverse-charge mechanism, even if the supply is paid for by a third party.

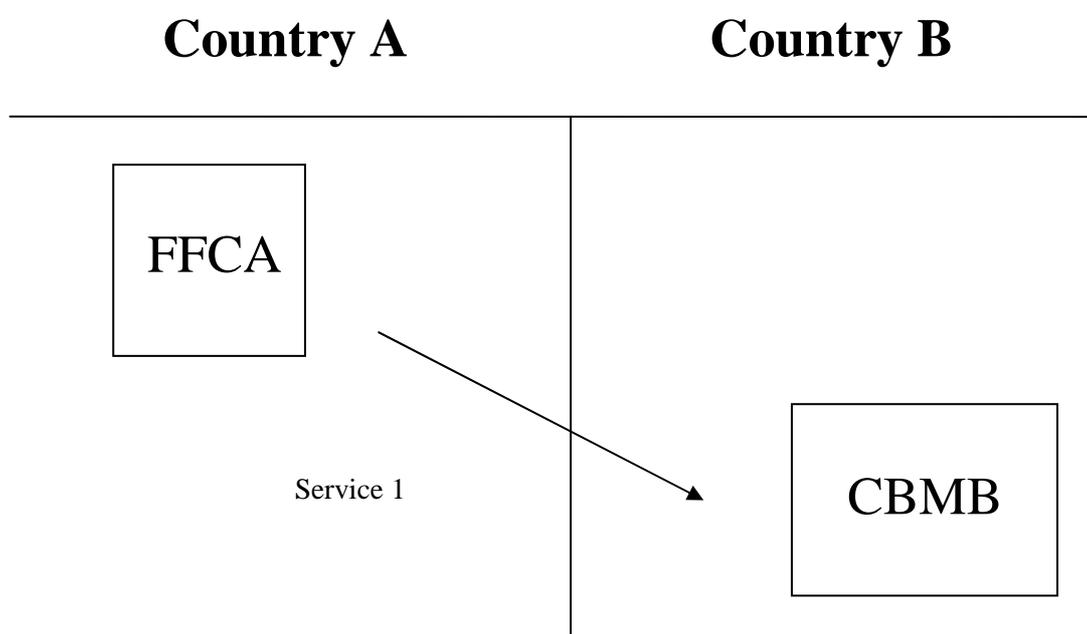
32. The above approach ensures a logical result since supplies are subject to tax in the jurisdiction in which the services or intangibles are consumed according to the Main Rule and there is neither double taxation nor unintentional non-taxation in any of the jurisdictions involved. Where this is not the case, tax administrations will need to ensure that supplies are not arranged in such a way as to artificially minimise or eliminate VAT liability for any of the parties concerned. Further guidance on dealing with tax avoidance and abuses are to be found in section [XX].

33. The Annexes provide some examples of how the Main Rule would be applied in simple cross border situations. The examples have served as basis to develop this guideline and might be helpful as explanatory back up to the paragraphs outlined in this guideline.

ANNEX

The examples in this Annex are provided to better illustrate the operation of the Main Rule. They are illustrative of the principles set out in the Guidelines and consequently are not intended to be exhaustive. Accordingly, the place of taxation of an international service will be determined according to the facts of each individual supply.

Example 1: Supply between 2 separate legal entities (whether related by common ownership or not):

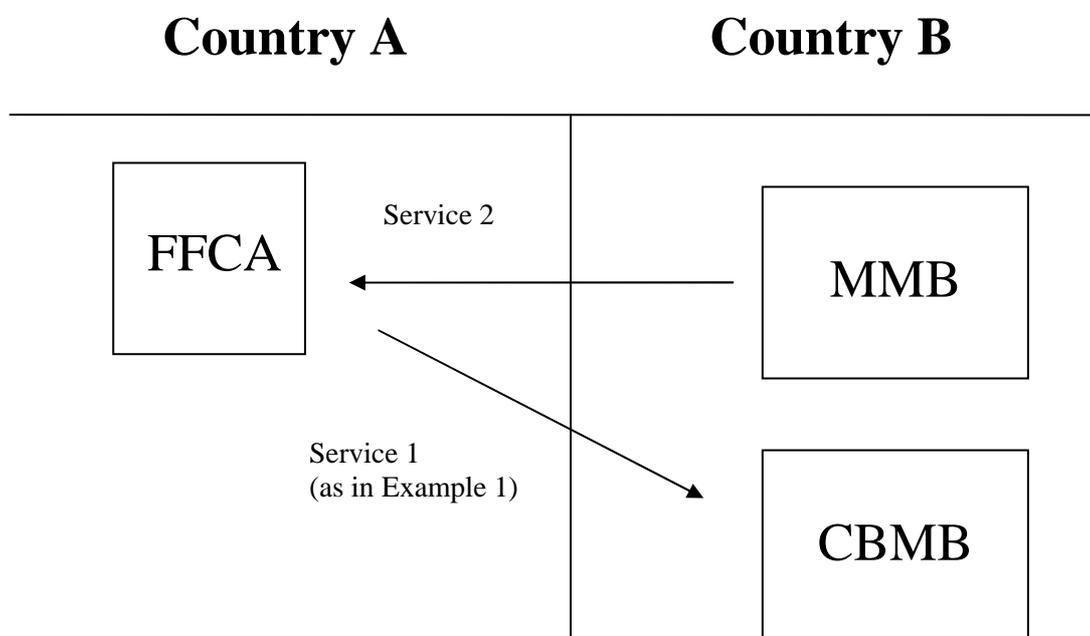


FF Consultancy (FFCA) is a business located in country A specialising in analysing retail food markets, CB Markets (CBMB) is a food retail business located in country B. Neither FFCA nor CBMB have other establishments for VAT purposes. CBMB is considering expanding its retailing activities beyond Country B and approaches FFCA. The two companies enter into a business agreement under which FFCA will provide an analysis of market conditions in Country A to CBMB. CBMB will pay FFCA a sum of money in return for FFCA performing its obligations under this business agreement.

According to the business agreement, FFCA will be the supplier and CBMB will be the customer. There will be a supply of a service provided by the supplier to the customer for consideration. In accordance with the Main Rule, the place of taxation will be country B, which is the country where the customer is located.

Subject to any issues arising from further work, the result remains the same even where the supplier and customer are two separate legal entities related by ownership.

Example 2: Two separate supplies involving three separate legal entities.



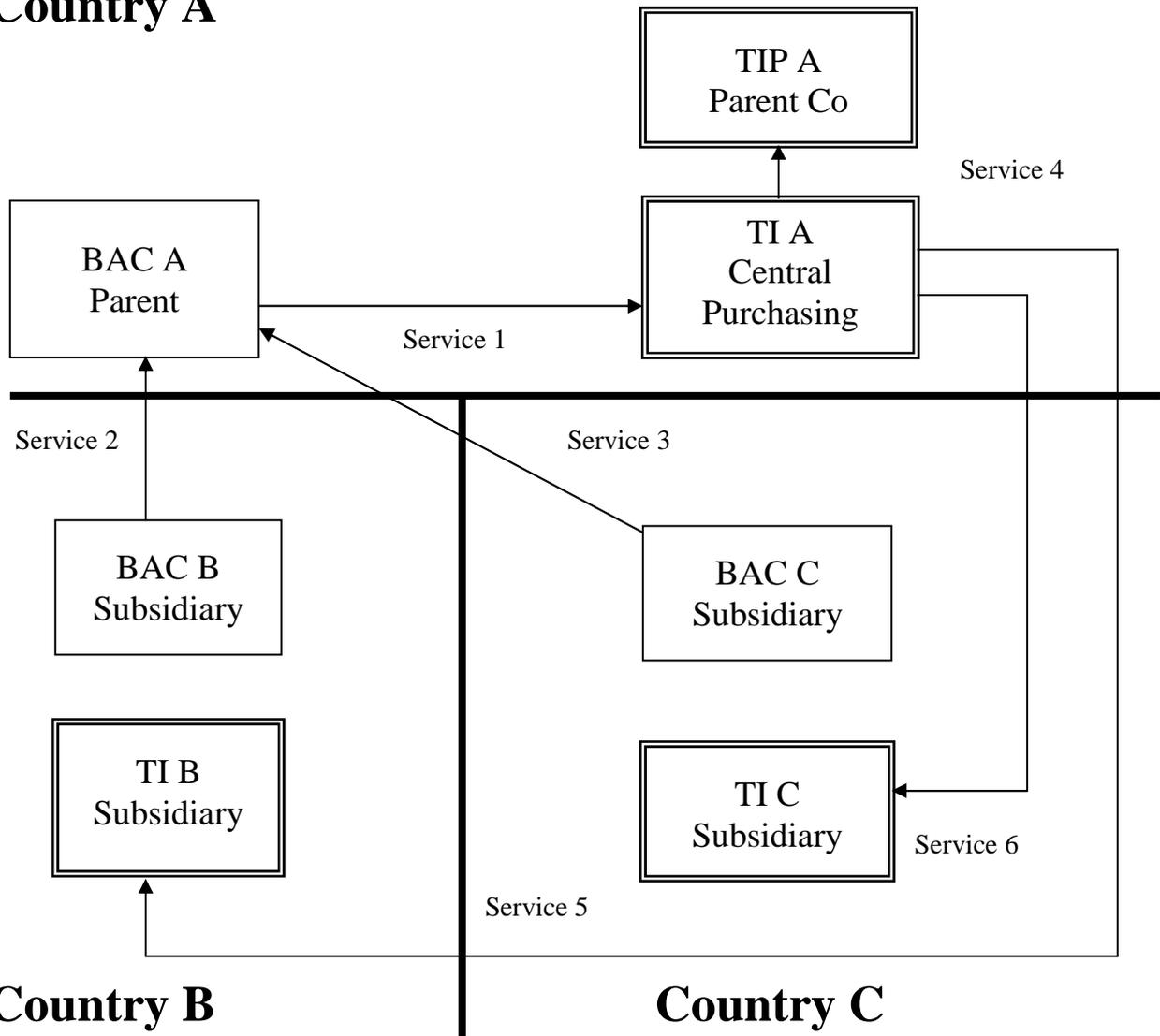
FFCA decides to expand its consultancy activities in Country B. In order to do so it engages the services of a marketing company in Country B – MMB, a company that has no ownership connection with FFCA or CBMB. MMB supplies its services of marketing to FFCA under a business agreement (service 2). The supply of service 1 between FFCA and CBMB (as outlined in Example 1 – analysis of the market conditions in country A) continues as before.

According to the business agreement MMB is the supplier and FFCA the customer. There is a supply of services for consideration. Therefore, in accordance with the Main Rule, the supply by MMB will be subject to taxation in Country A because that is the country where the customer is located. These are two independent supplies and are treated accordingly. The outcome of service 1 as outlined in Example 1 remains unaffected.

Example 3: 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



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.²⁴

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.

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 render 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 supplies. 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.

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.

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.

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 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 rendered is not relevant in this example to determine the place of taxation, as the place of taxation will still be the customer location and not where or to whom the services are rendered.

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.

²⁴ 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.

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.

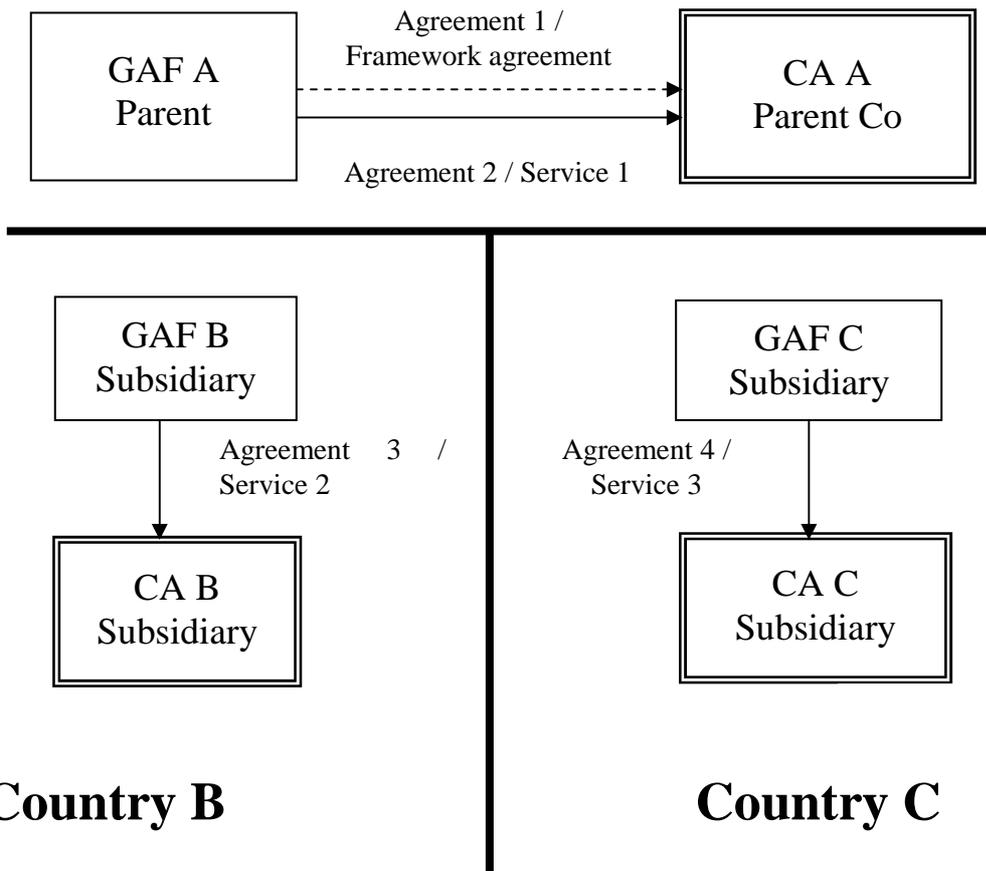
In developing this example, care has been taken to avoid any stewardship issues that may exist with respect to TIP A. In other words TIP A, as the parent, may also be seen as deriving an element of benefit from the audit activities in countries A, B and C, for example because such audit included an additional review of financial statements under the parent company's country accounting standards, rather than only per local subsidiary country accounting standards. Stewardship issues²⁵ do not arise in example 3 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.

²⁵ 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 4: 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.²⁶

Country A



Country B

Country C

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.

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

²⁶ 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.

when members of GAF A and CA A enter into separate agreement referring to this framework agreement. The agreement also provides that 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.

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.

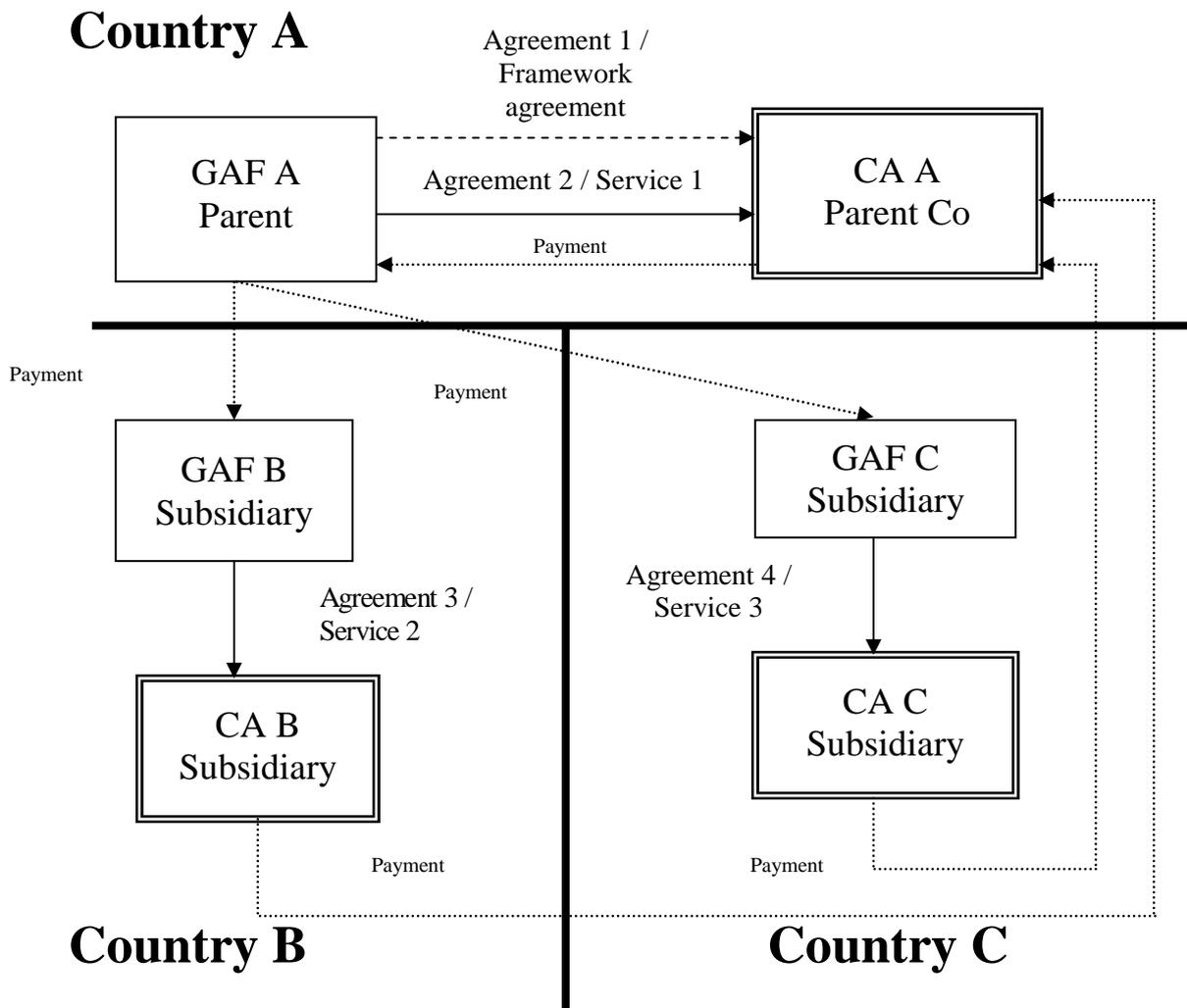
There are four separate business agreements in this example, only three of which lead to a supply of a service for consideration. The first agreement (Agreement 1) is not transactional, has no consideration and does not create a supply. Agreement 1 stipulates terms and conditions which only become activated 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.

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.

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 supplies 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 5: Alternative global agreement – different flow of payment

This example expands upon example 4 by introducing payment flows that are different from the flows of the services as set out in the underlying business agreement.



This example is similar to example 4 except that the CA group has put in place a system for settling inter-company supplies 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.²⁷ The Framework Agreement in this example is similar to example 4 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.

²⁷ 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.

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 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.

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.

The conclusions reached in example 4 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.

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.