TAX EXECUTIVES INSTITUTE, INC.

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Via email: piet.battiau@oecd.org

Re: International VAT/GST Guidelines

Dear Mr. Battiau,

On 18 December 2014, Working Party No. 9 on Consumption Taxes of the Organisation for Economic Co-operation and Development (OECD) released a consultation document setting forth two new draft elements (the Discussion Draft) of the International VAT/GST Guidelines (the Guidelines). The elements address the place of taxation for business-to-consumer (B2C) supplies of services and intangibles. In its Report on Tax Challenges of the Digital Economy, which was prepared in context of work on Action 1 of the BEPS Action Plan, the OECD identified this area as a "pressing issue that needs to be addressed urgently to protect tax revenue and to level the playing field between foreign suppliers relative to domestic suppliers."

Tax Executives Institute (TEI) commends Working Party No. 9 for its work on the Guidelines. Crafting globally applicable approaches for use in countries with different legal frameworks, customs, and backgrounds is a difficult task. The benefits of that work, however, are significant. All countries have the common objectives of fair taxation, maintaining (or achieving) a level playing field between domestic and foreign vendors, and the efficient collection and enforcement of their tax

systems. In the specific context of electronic commerce, it is in the interest of all parties to ensure a consistent global approach in line with OECD principles and guidelines. As the International President of TEI, I am pleased to submit the following comments on the Discussion Draft.

Tax Executives Institute

TEI was founded in 1944 to serve the professional needs of business tax professionals. Today, the organisation has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent 3,000 of the largest companies in the world.[1]

TEI Comments

General Comments

Countries around the world struggle with the application of consumption taxes to supplies of services and intangibles, especially when those supplies are made by businesses with no presence in the country of their customers. During the past decade, a number of countries have developed approaches for addressing B2C supplies of services and intangibles. For example, effective 1 January 2015, the European Union introduced a new set of rules and registration requirements for supplies of electronically-delivered services. Norway has been taxing sales of electronic services made by foreign (non-established) vendors to Norwegian customers and operating a simplified registration and collection system since July 2011. Beginning 1 June 2014, South Africa introduced a set of rules addressing this same part of the economy. Finally, Canada and Japan continue to analyse different approaches to ensure the proper amount of GST and CT, respectively, is collected on these transactions. As more countries introduce measures governing the application of their VATs to supplies of services and intangibles, there is greater risk of creating a patchwork of inconsistent rules that could (and often do) result in double taxation or double non-taxation, thereby eroding the principle of neutrality, which is critical to a properly functioning international VAT system. TEI commends the OECD and Working Party No. 9 for their ongoing efforts to develop international VAT guidelines and appreciates this opportunity to comment on the Discussion Draft.

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[1] TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

Comments on Specific Areas of the Discussion Draft

The Discussion Draft adds two new elements to the Guidelines that were approved at the OECD Global Forum on VAT held in Tokyo in April 2014: (1) Chapter 3 – Determining the Place of Taxation for Cross-Border Supplies of Services and Intangibles; and (2) Chapter 4 – Supporting the Guidelines in Practice – Mutual Cooperation, Dispute Minimisation, and Application in Cases of Evasion and Avoidance. Chapter 3 of the Discussion Draft also includes an annex discussing the main features of a simplified registration and compliance regime for non-resident suppliers.

Paragraph 3.5: Guideline 3.1 of the Discussion Draft addresses the application of the destination principle to supplies of services and intangibles. In Paragraph 3.5, there is a discussion of the differing objectives between taxing business-to-business (B2B) supplies and B2C supplies. Taxation of the former is aimed at ensuring the neutrality of the international VAT/GST system while taxation of the latter is designed to collect tax in the jurisdiction where the ultimate consumer is likely to consume the services or intangibles. Many jurisdictions employ separate rules for B2B and B2C supplies to aid in achieving these objectives, but other jurisdictions do not. The final sentence of Paragraph 3.5 provides that "[t]his should not be interpreted as a recommendation to jurisdictions to develop separate rules or implement different mechanisms for both types of supplies in their national legislation."

Comment: The final sentence of Paragraph 3.5 could be viewed as running counter to Annex 3, which provides a framework for a simplified registration and compliance regime aimed at non-resident suppliers of B2C services and intangibles. Generally, non-compliance in this area occurs with B2C supplies where VAT/GST is a cost, rather than at the B2B level where it is rarely a cost (except for "exempt" or "input taxed" businesses). Requiring collection of VAT/GST on B2B supplies by foreign suppliers, rather than by their domestic customers through a reverse-charge mechanism (where appropriate), would create a new administrative burden without enhancing compliance with, or collection of, local VAT/GST. Thus, we recommend amending the last sentence of Paragraph 3.5 by adding the following parenthetical (underlined):

This should not be interpreted as a recommendation to jurisdictions to develop separate rules or implement different mechanisms for both types of supplies in their national legislation (with the exception of the recommendations in Annex 3).

The recommendations contained in Annex 3 regarding a simplified registration and compliance regime for non-resident suppliers would make the VAT/GST collection process more efficient for both tax administrators and business. It would also better align with OECD recommendations recently endorsed by governments at the second meeting of the OECD

Global Forum on VAT in Tokyo, where the reverse charge mechanism was recommended as the preferred collection mechanism in B2B scenarios.

Subsection C.3.1: To best achieve taxation in the jurisdiction of consumption, Guidelines 3.5 and 3.6 provide a two-step process. The first step, Guideline 3.5, applies where the services or intangibles are physically performed at a readily identifiable location, are ordinarily consumed at the same time and place where they are physically performed, and ordinarily require the physical presence of both the supplier and purchaser at the same time and place. When Guideline 3.5 does not apply, Guideline 3.6 deems the place of supply to be the jurisdiction where the customer has its usual residence. The Discussion Draft goes on to discuss the documentation on which suppliers can rely to determine customer residence.

Comment: TEI welcomes the clear distinction achieved by Guidelines 3.5 and 3.6. So-called "on the spot supplies" will achieve the correct tax result through the application of Guideline 3.5 regardless of whether purchasers are in transit. Deeming the place of supply to be the jurisdiction of residence for all other services and intangibles is the only logical and practical conclusion.

The commentary in Paragraphs 3.23 and 3.24 concerning the determination of acceptable evidence for businesses to identify the residence of their customer is generally helpful and practical. The language recognises the impossibility of achieving absolute certainty as to customer residence in every transaction and urges jurisdictions (as much as possible) to permit suppliers to use documentation produced or collected as part of their normal business activity. Paragraph 3.23 introduces the concept of reasonably reliable evidence as a standard for whether suppliers have met their burden to prove the residence of their customers. Again, the practicality of that standard is a welcome inclusion in the Discussion Draft.

By focusing on the difficulties of obtaining documentation sufficient to prove the residence of a customer, these paragraphs de-emphasise the ability of suppliers to obtain highly reliable documentation to establish residence in circumstances. It is often the case that low-value supplies made with minimal interaction between supplier and customer may limit the ability to secure that documentation. But, in other cases, a supplier and its customer will enter into a contract that provides reliable data on customer residence. In that case, the contract will be more accurate than two pieces of less reliable evidence, making an evaluation of the quality of the evidence even more important than the quantity of evidence. It should be made clearer in Paragraphs 3.23 and 3.24 of the Discussion Draft that it may be acceptable for suppliers to rely on a single piece of evidence with a high degree of reliability. For example, information provided to a supplier by a payment processor, such as a credit card or bank, is more reliable for identification of customer residence than an IP address.

Paragraph 3.23 suggests that jurisdictions should consider rules limiting challenges by the taxing authority to situations where "there is misuse or abuse of such evidence." As a general matter, we view such rules as being positive. It would be helpful, however, for the OECD to provide some indication of "misuse or abuse" that might trigger a challenge to the use of otherwise acceptable evidence. If an exception for misuse or abuse of evidence is interpreted broadly, it would defeat the anticipated benefit of heightened compliance at a lower cost for businesses and tax administrations.

The observation at the end of Paragraph 3.24 that the indicia of residence used by businesses to support their place of supply determinations will "likely evolve over time as technology and business practices develop" is astute and helpful. TEI urges the OECD to take the recommendation in Paragraph 3.24 one step further. Jurisdictions should be advised to craft their rules in a way that permits flexibility in responding to future changes in technology and business processes.

Subsection C.3.2: This subsection provides guidance for the implementation of registration systems for non-resident suppliers and is a welcome addition to the Guidelines. TEI commends the OECD for addressing this issue, which has become a focus of many jurisdictions over the past few years.

Comment: One point absent from this subsection is any mention of thresholds for very small suppliers, i.e., suppliers that only generate a very small level of revenues in a particular jurisdiction. Experience from TEI members in jurisdictions that have implemented these types of registration systems confirms the need to exclude very small suppliers from the tax net. The costs for small suppliers to comply and for tax administrations to manage the registrations of these small suppliers outweigh any benefit generated by their registration. This point could also be bolstered in Paragraph 16 of Annex 3, which addresses proportionality issues. Just as important, jurisdictions should provide clear guidance on their websites to facilitate compliance so that sellers of all sizes can quickly and easily register and comply with the applicable rules.

Guideline 3.7: In limited situations, a specific rule for determining the place of supply for a transaction will more likely result in the transaction being taxed in the jurisdiction of consumption. Guideline 3.7, in Paragraph 3.39, provides a helpful five-factor evaluation framework for assessing the desirability of specific rules. The second of the five factors is "efficiency of compliance and administration."

Comment: TEI agrees that specific rules for determining place of supply should be limited. The evaluation criteria in Paragraph 3.39 are critical for evaluating when a special rule is appropriate. Automation through technology has helped ease the VAT/GST compliance burden for businesses, and the OECD is correct to include "efficiency of compliance and administration" in the evaluation criteria. TEI urges the OECD to add language to Paragraph

3.39 indicating that the ability to automate tax decision-making should be considered when evaluating such efficiency.

Annex 3: Annex 3 provides helpful guidance for jurisdictions establishing or maintaining registration and compliance regimes for non-resident suppliers, in particular exploring the key measures that taxing jurisdictions could take to simplify the administrative and compliance processes of a registration-based collection regime for B2C supplies.

Comment: Given the importance of this work, TEI recommends that this topic be included as a separate chapter in the Guidelines rather than consigned to an annex. In addition, whilst the application of the reverse charge is the preferred main rule approach and is fully supported by business for B2B cross-border transactions, there may be some merit in investigating whether a simplified registration regime might be beneficial in B2B scenarios where the reverse charge does not apply.

Annex 3, Paragraph 13: One of the key elements of VAT/GST regimes generally, and specifically those portions applicable to non-resident suppliers, is the availability of guidance from tax authorities to ensure compliance. Paragraph 13 encourages jurisdictions to make that guidance available online in a manner that is kept current and in the language of the jurisdiction's main trading partners.

Comment: Researching the VAT/GST treatment of transactions for all jurisdictions in which a supplier has customers is a time-consuming and expensive process. This is especially true when determining how, when, and where to declare and pay VAT/GST outside the home country of the business. Maintaining easy-to-understand, up-to-date guidance in an online format would benefit both tax administrators and businesses. For example, it would help safeguard VAT/GST revenues of jurisdictions through more accurate reporting and, at the same time, reduce the administrative burdens and compliance costs for businesses.

Annex 3, Paragraph 14: The recommendations in Annex 3 recognise that the simpler jurisdictions make their compliance systems, the more likely it is that businesses are able to register and comply. Paragraph 14 suggests allowing suppliers to use third-party service providers to "act on their behalf in carrying out certain procedures, such as submitting returns," as a way to help small and medium-sized business with their compliance.

Comment: Some jurisdictions already require use of a local agent to comply with their VAT/GST obligations. Use of those third party agents creates an additional expense for the business. One of the biggest barriers to compliance in jurisdictions with low value sales is when the cost of compliance outweighs the benefits of continuing to do business in the jurisdiction. Both the business and its potential customers lose in that situation. To avoid any implication that the Discussion Draft is promoting the mandatory use of third party agents for VAT/GST

purposes, TEI urges the OECD to add language to Paragraph 14 of Annex 3 clarifying that use of third party agents should be optional for businesses.

Chapter 4, Section A: Chapter 4 recognises that it is appropriate to identify mechanisms that may help facilitate the interaction between tax administrations to avoid instances of double taxation and unintended non-taxation, to facilitate the minimisation of disputes over potential double taxation or unintended non-taxation, and to deal with evasion and avoidance.

Comment: Prevention is the best way to minimise disputes – the more consistently the Guidelines are interpreted and implemented at a global level, the less often disputes regarding neutrality and place of taxation issues should occur. However, in practice, TEI recognises that there will always be exceptional instances where jurisdictions will implement or interpret the neutrality or place of taxation principles in different ways. In this context, it is clear that Chapter 4 is crucial in trying to resolve disputes as and when they occur. TEI maintains that mutual cooperation and the exchange of information between governments is vital not only to aid in the resolution of disputes regarding the Guidelines, but also to make compliance as simple as possible for business and to create efficiency for both business and tax administrators when managing VAT/GST in practice.

Paragraph 4.5: The Guidelines have been developed on the presumption that all parties are acting in good faith, and that all transactions are legitimate and possess economic substance. Where there are efforts to avoid or evade taxation, however, Paragraph 4.5 recognises that it is not inconsistent with the Guidelines for jurisdictions to take proportionate counter-measures to protect against evasion and avoidance, revenue losses, and the distortion of competition.

Comment: TEI appreciates the need for governments to take measures in the context of the Guidelines to protect against evasion and avoidance. Because such measures create distortions of competition for business, however, TEI urges the OECD to emphasise the need for governments to apply these measures responsibly and proportionately, only in cases of abuse, and consistent with the principles of these Guidelines, particularly the principle of neutrality.

Furthermore, any such measures should also be applied in a way that is specifically directed to tackle the perceived abuse. As TEI members have experienced in practice, rules that are insufficiently targeted increase the complexity and cost of compliance for legitimate businesses, whilst doing little to diminish evasion or avoidance at an overall level. Consistent with this, TEI recommends that the OECD encourage tax authorities to ensure that penalties for genuine mistakes (which frequently occur in the complex day-to-day commercial and taxation environment) be proportionate and take into consideration the net amount of revenue lost.

To this end, TEI also notes that many of the e-services that are addressed in these Guidelines are provided through lengthy supply chains with frequently a number of third

parties involved between the content owner and the final consumer. In such cases, the taxpayer responsible for charging, collecting and remitting the VAT/GST must rely on those third parties for the information declared on their VAT/GST filings. This information is often provided too late to allow for timely filing of one's entire liability. TEI urges the OECD to encourage tax authorities to adopt a flexible approach in such cases and to accept that unless the delays are significant (six months or longer) no penalties should be imposed in instances where a taxpayer files figures received from third parties in later periods than they otherwise should under the rules.

VAT/GST & BEPS – General Points

TEI would like to highlight several corporate tax related BEPS action items that impact VAT/GST – e.g.:

Lowering of the permanent establishment (PE) threshold will result in additional VAT/GST registration and compliance obligations with an overall increase in administrative costs to businesses. Increased complexity is also likely to occur – either through a more extensive use of force of attraction rules, or through an increased risk that conflicting establishment definitions create double taxation and unintended non-taxation, particularly if the Guidelines are not implemented and applied consistently.

Looking at this from the other side – i.e., the impact of VAT/GST registrations on PE considerations - Footnote 24 of the Guidelines highlights that a VAT/GST registration should not by itself create a PE. Because this is such a critical point, TEI recommends that it be placed in the body of the document, rather than in a footnote, as it currently appears. Experience from TEI members suggests that more and more tax authorities are trying to reclassify a VAT/GST only registration as a PE for corporate tax purposes. The globalisation of trade of cross-border supplies and the growing use of the Internet, combined with VAT/GST rules, means that businesses are increasingly required to charge and account for VAT/GST in countries where they do not have a physical presence. Given the potential wider tax implications at stake, there is a risk that such an approach may lead to increased revenue losses for governments if businesses are deterred from acting as tax collector for VAT/GST. In turn, this will also lead to increased distortion of competition for businesses.

With respect to transfer pricing adjustments, where there is a lack of consistency between governments as to how transfer pricing adjustments should be treated for VAT/GST purposes, there is an increased risk of double taxation, unintended non-taxation, and legal uncertainty.

Corporate restructuring prompted by BEPS actions also is likely to lead to additional VAT/GST costs since there are often different deduction approaches for restructuring costs between corporate tax and VAT/GST and between different tax authorities.

TEI urges the OECD to ensure that all its tax units and working parties interact closely with each other, to discuss the potential effects of the action items on VAT/GST, and align the taxes where possible.

Conclusion

Clear and uniformly interpreted VAT/GST rules that are simple, consistent, flexible and proportional, particularly with respect to the place of taxation and the means of collecting the tax, have the dual effect of safeguarding tax revenues and achieving a level playing field for business. TEI applauds the excellent work by the OECD on VAT/GST in the last few years and for involving business stakeholders in the Technical Advisory Group process and other initiatives leading to the development of the Draft Guidelines. Cooperation between business and governments on an international level is vital to ensuring the operation of a functioning VAT/GST system.

TEI's comments on the Discussion Draft were prepared by the Institute's European Indirect Tax Committee, whose chair is Jean-Francois Turgeon. If you have any questions about TEI's comments, please contact Mr. Turgeon at +41 (0) 582 426 513 or turgeon_jean-francois@cat.com, or Pilar Mata of TEI's legal staff at +1 202 638 5601 or pmata@tei.org.

Sincerely yours,
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