

VAT and GST Refunds

Towards more business-friendly mechanisms?

Some countries cite their form of value added tax as a goods and services tax (GST). For ease of reading we refer in this article to all value added taxes as VAT.

Neutrality of VAT v the real world

Businesses sometimes incur VAT on expenses in a foreign country while having no taxable activity or being established in that country. These expenses may be related to the economic activity of those businesses outside that country and, if so, those businesses should legitimately be entitled to recover the VAT charged to them on those expenses. Because VAT, by its very nature, is supposedly neutral for VATpayers, the burden of the tax should not fall on taxable businesses. VAT should in principle only tax consumption by final consumers. Businesses should be entitled to deduct the tax on their purchases and offset that tax against the tax they normally collect on their own sales.¹

In the real world things are a bit different. It would seem that not all countries implement refund mechanisms and that some of the countries that do so have such complex or burdensome practices that they are difficult for businesses to apply in practice. In these circumstances VAT might in the end be a cost for businesses. Even when refunded, the amount of time required to obtain the refund creates a cash flow cost for businesses to which should be added the costs of making the refund claims themselves.

In the particular context of the financial crisis, where cash flow is even more significant, this topic is of growing importance.

The European Union

Different practices are implemented around the world.

In the European Union (EU),

Alain Charlet and Stéphane Buydens discuss the cross-border VAT refund mechanisms and show how jurisdictions and businesses cooperate in the international OECD forum to improve existing practices

the now relatively well-integrated VAT system has ensured that refund claim mechanisms have been largely harmonised. When the foreign business incurring VAT is located outside the EU, the refund procedures are governed by the 13th VAT Directive 86/560/EEC of 17 November 1986. When the foreign business is located within the EU, the 8th VAT Directive 79/1072/EEC of 6 December 1979 is applicable. Those procedures are open to all businesses that incur VAT in an EU Member State when they are not established for the purpose of their activity, nor registered in this Member State (that is, when they

quicker refunds for claimants, who will be able to initiate the procedure through the tax administration of their country of establishment. The new Directive implements a more business-friendly procedure, so as to improve the functioning of the internal market.

Other countries

Other countries have different strategies. Some countries simply do not provide a refund procedure. This means that in some cases VAT becomes a cost for foreign businesses. This might create a disincentive to invest in those countries, as usually a business that

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do not carry out a taxable activity in the EU Member State of the refund).

The EU recently adopted a new Directive 2008/9/EC of 12 February 2008 repealing with effect from 1 January 2010 the previous 8th VAT Directive, and replacing it. This Directive should 'enhance the position of businesses',² as it was perceived that 'the current paper-based procedure is slow, cumbersome and costly'.³ The new procedure, which will apply to refund applications submitted after 31 December 2009, will be fully electronic and the intention is to ensure

decides to set up in a country will incur costs before commencing a taxable activity (although rules exist in many jurisdictions that allow recovery of the VAT incurred for the purpose of setting up a domestic taxable activity).

Some of the countries that do not have a refund procedure do, however, allow recovery of the tax through a registration mechanism. Usually, in the EU, a business can only register for VAT in a country – and has to – when it carries out a taxable activity in that country, which means that it will be considered as a domestic VAT taxpayer

in that particular country. In some other jurisdictions, such as Canada, it is possible to register in that country while not having a taxable activity in Canada, for the sole purpose of recovering the Canadian VAT incurred.⁴

Yet other countries, such as New Zealand, have chosen to deal with that problem by implementing a wide series of exemption provisions when supplies are made to non-resident companies. There do remain examples of countries where the VAT will be a cost to foreign businesses because the issue has not been covered by any of these provisions. In such circumstances, those businesses will have to implement strategies of their own in order to avoid bearing that non-recoverable VAT cost. They may, for instance, develop a small taxable activity in that country that allows them to offset their input tax.

The perception of business

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those procedures. Some countries do require reciprocity agreements with the claimant's home country (where the claimant is established in a non-EU country and is claiming a refund in an EU country, for example)⁶ before making any refund, which means that some countries are 'blacklisted'. Some countries require that the claimants appoint a tax representative, who is usually in charge of completing all of the formalities related to the claim and is normally jointly liable with the claimant. The requirement to appoint a tax representative is, for instance, an option given to the EU Member States under the 13th VAT Directive, Art 2(3). Businesses are also concerned about the compliance burdens and cost of the procedures that are frequently paper-based and use the local language. There are also concerns about the length of the procedure: the survey results suggest that some administrations ask many more questions than others and that the time for processing claims differs considerably from one country to another.



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business and some countries that do not have refund mechanisms could well be influenced to provide some form of appropriate mechanisms.

The OECD will be carrying out a new survey in May 2009. This has been developed in collaboration with government and business representatives. It will create a unique opportunity for the broader business community to express its views about the means of ensuring that VAT is not incurred in such a way as to be an economic cost. Depending on the outcome of the survey, it is possible that the OECD may develop some guidelines on best practices, or at least some clearer guidance on how best to ensure fiscal neutrality.

In the context of the current crisis many countries, such as France,⁷ have already implemented specific provisions to facilitate the refund of VAT credits to their domestic businesses and it might be consistent to extend these measures to foreign businesses. International co-operation is needed, as neither countries nor businesses can be expected to solve problems in isolation. The OECD work on international VAT issues is well under way and guidance on ensuring neutrality for business may well form an important element. More information on the OECD's work on consumption taxes is available at www.oecd.org/ctp/ct.

Notes

¹ There are some exceptions. Sometimes businesses are not entitled to deduct the VAT on their purchases so that VAT becomes a cost. Many countries, for instance, exempt specific activities

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Businesses actively participate in the OECD's work on consumption taxes and they meet with government representatives in a Technical Advisory Group (TAG) to discuss these issues. A preliminary survey of businesses in July 2008 was an attempt to assess the magnitude of the issue. The answers received showed that the refund of foreign VAT is a major issue for many respondents. This confirmed a survey previously made by the IMF that showed that 'refunding of credits ... has been a source of tension between tax authorities and the business sector and, in some countries, has led to complex administrative measures that have significantly undermined the functioning of the VAT system'.⁵

Even when refund procedures are in place, businesses are often concerned about the complexity of

The need for global co-operation

On the other hand, granting refunds to businesses with no 'presence' in a country inevitably brings an element of risk for tax administrations. The absence of 'jurisdictional power' over these businesses, or the lack of appropriate exchange of information procedures or assistance in recovery may well leave the tax administration exposed to fraudulent claims, with little hope of recovering any incorrect refund payments.

The result of the preliminary survey made by the OECD in July 2008 suggests that there is a strong need for co-operation on the refund issue between businesses and governments.

Discussions in a global forum such as the OECD's Working Party on Consumption Taxes, through its regular interaction with business in the TAG, help to achieve a better balance between the interests of all parties. Governments better appreciate the concerns of



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from VAT and do not allow businesses involved in those activities to deduct the VAT on their purchases linked to those exempt activities.

In some countries, those activities are referred to as 'input taxed' rather than exempt. Health and financial services are amongst the most current

exemptions. It may happen also that some countries have implemented specific input tax 'blocks' with respect to certain types of supplies of services or goods. VAT on purchases of vehicle fuel, for instance, is not or only partly recoverable in France depending on the type of fuel that is consumed (article 298 4. 1° and 1° bis of the French tax code). These exceptions affect the neutrality of VAT and may create tax cascading effects.

² See point (3) of the new Council Directive 2008/9/EC of 12 February 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State.

³ See <http://www.lexisurl.com/yPfz1>.

⁴ Canadian Excise Tax Act, s 240(3).

⁵ Harrison, G. and Krelove, R. (2005). *VAT refunds: a review of country experience*, IMF Working Paper WP/O5/218, IMF, Washington.

⁶ This is an option given to EU Member States by the 13th VAT Directive, Art 2(2)).

⁷ See the French 'Décret' n° 2009-109

dated 29 January 2009 '*relatif aux modalités d'option pour un régime d'imposition d'après le chiffre d'affaires réel et de remboursement des crédits de taxe sur la valeur ajoutée*').

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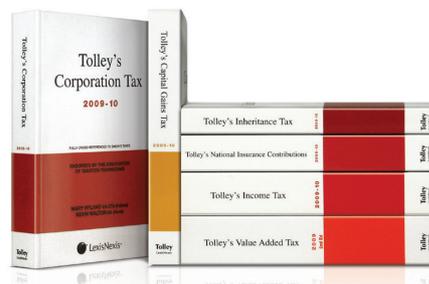
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