

VAT Focus

Draft OECD VAT/GST Guidelines

SPEAD READ The OECD released the draft VAT/GST Guidelines for public consultation in February 2010. These draft Guidelines propose that the place of taxation of internationally traded services or intangibles is the location of the customer. The parties to a supply are normally determined by a 'business agreement', which is a non-legal concept much broader than a written contract. The draft covers business-to-business supplies between single location entities. It assumes that all supplies are legitimate and with economic substance and that there is no artificial tax avoidance or tax minimisation taking place. These draft Guidelines will be expanded to cover supplies between entities with multiple locations.



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At its meeting in January 2010, the OECD Committee on Fiscal Affairs (CFA) approved the publication on the OECD website for public consultation of the draft OECD VAT/GST Guidelines on the place of taxation of internationally traded services or intangibles (www.oecd.org/ctp/ct).

The drivers for this work were the changes in technology and business models that had led to significant increases in supplies of services and intangibles across international borders.

This work started in 2006 when the Committee

Box 1: The Business Agreement

According to the draft Guidelines (§ 5 to 12 of s 3), 'Business agreements consist of the elements that identify the parties to a supply and the rights and obligations with respect to that supply. They are generally based on mutual understanding'. 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, potentially very wide in its application.

Box 2: The Main Rule

The draft Guidelines say that 'For business-to-business supplies, the jurisdiction in which the customer is located has the taxing rights over internationally traded services or intangibles' (introduction of s 3 of the draft Guidelines). The draft Guidelines propose therefore as a Main Rule that the location of the customer is the most appropriate proxy to determine consumption for business-to-business supplies. The draft Guidelines indicate that 'The identity of the customer is normally determined by reference to the business agreement'. It follows that, when the customer is a single location entity, the business agreement determines the location of the customer.

agreed that internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption. Consultation documents, testing a number of business scenarios, were issued by the Committee in 2008 (www.oecd.org/ctp/ct). Since it is not practicable to tax consumption directly, it was agreed to use proxies to determine where consumption occurs and thus which jurisdiction has the right to tax.

Working assumptions

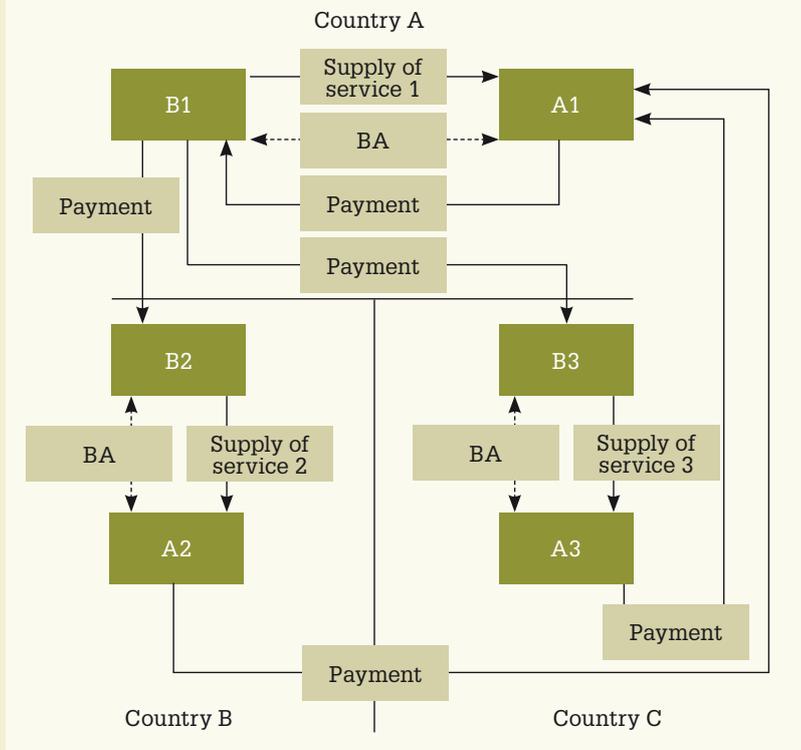
When considering the appropriate proxy to determine the place of taxation of supplies of services and intangibles, the draft Guidelines assume that all supplies are business-to-business, are legitimate and have economic substance. It is also assumed that no tax avoidance or artificial tax minimisation is taking place. Further, all supplies are deemed to be between separate legal entities with single locations only. A distinction is made between 'services' and 'intangibles' because, unlike in the European Union, some jurisdictions consider intangibles as a separate category.

Application of the Draft VAT/GST Guidelines to a global agreement

Under our example, A1 is a parent company of a group (Group A). A1 is located in Country A and is entering into a global agreement with the parent company of an audit group (Group B) in order to provide audit services to itself and its subsidiaries located in several different countries. The purpose of this global auditing service is to allow Group A to comply with legal requirements in the countries where its companies are located. The parent company of the audit group is named B1 and is also located in Country A. The subsidiaries of A1 are A2 and A3 and are located in Countries B and C. The subsidiaries of B1 are B2 and B3 and are located in Countries B and C (see Figure 1).

The global auditing service is concluded by A1 with B1 for the whole Group A. This global auditing service is a framework agreement that covers definitions, obligations relating to confidentiality, warranties, due dates for payment and limitations of liability that would apply only if and when members of Group A and Group B enter into separate agreements referring to this framework agreement. The agreement provides that companies that are affiliated with Group A and Group B may enter into business agreements that will incorporate the terms of the framework agreement by reference. The framework does not oblige any member of Group A and Group B to enter into such business agreements. The framework agreement is not transactional, has no consideration and does not create a supply. It stipulates terms and conditions which only become activated when parties agree to separate business agreements as specified in the framework agreement.

Figure 1: Framework agreement involving 3 countries



In this example, A1 enters into a business agreement with B1; A2 enters into a business agreement with B2 and A3 enters into a business agreement with B3. In each of these agreements, an article is included where the parties agree to incorporate the terms included in the framework agreement. These business agreements are not necessarily contracts (see Box 1 for additional explanation) although it is likely that, in our example, they would be regarded as contracts by the laws of Country A, B and C.

Furthermore, A1 is the *common paymaster of the group*. Therefore payments for the services supplied under the locally concluded business agreements will be handled by A1 directly with B1 for the whole of group A. B1 will issue an invoice to A1; B2 will issue an invoice to A2 and B3 will issue an invoice to A3. However for payment purposes, B1 will issue a collective statement (with copies attached of the invoices issued for the services supplied) to A1. Based on the collective statement A1 will pay the requested amount to B1 and will on the same day collect the respective amounts from A2 and A3. Similarly B1 will transfer the respective amounts over to B2 and B3 on the same day it receives the payment from A1. The movements of payment are simply cash or account entries. The payment A1 makes to B1 represents consideration for the services supplied from B1 to A1, from B2 to A2 and from B3 to A3.

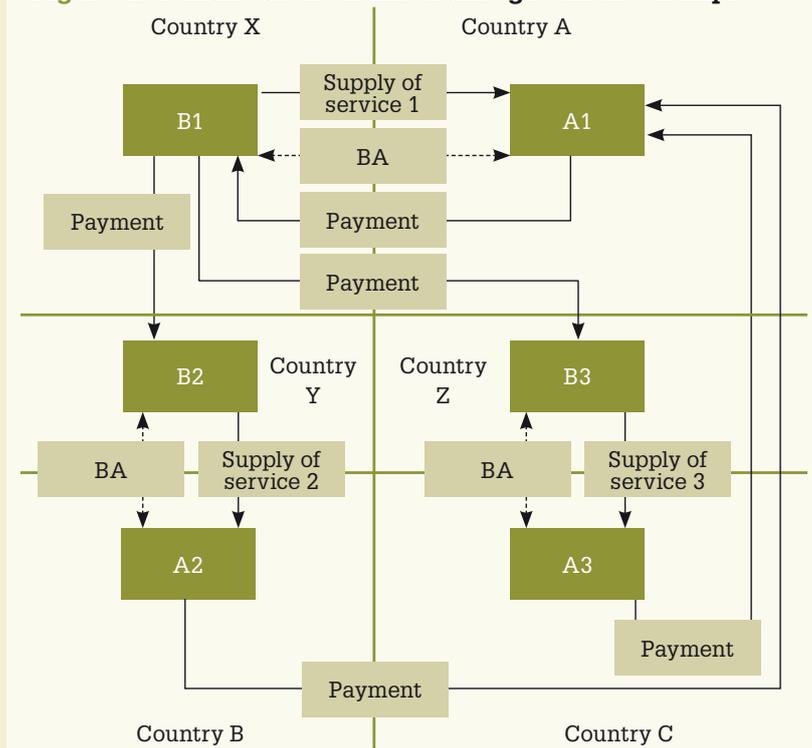
According to the Main Rule as defined by the draft OECD VAT/GST Guidelines, all supplies made under the business agreements are subject

to the taxation rules in the jurisdiction where the customer is located (see Box 2 for additional explanation). The business agreement identifies the customer. Since the customers in our example are single legal entities, it follows that the business agreements identify the location of the customers.

Therefore, in our example, under the business agreement concluded between A1 and B1, B1 is the supplier and A1 is the customer. Therefore, in accordance with the Main Rule, the place of taxation for the supply between B1 and A1 will be in Country A as A1 is located in Country A. Similarly, under the business agreement concluded between A2 and B2, B2 is the supplier and A2 is the customer. Therefore, in accordance with the Main Rule, the place of taxation for the supply between B2 and A2 will be in Country B as A2 is located in Country B. Under the business agreement concluded between A3 and B3, B3 is the supplier and A3 is the customer. Therefore, in accordance with the Main Rule, the place of taxation for the supply between B3 and A3 will be in Country C as A3 is located in Country C. No supplies take place under that agreement and no place of taxation issue arises.

The outcome leads to an appropriate tax result as there is neither double taxation nor unintentional non-taxation in Countries A, B or C. For simplification purposes, there were

Figure 2: Variant of the framework agreement example



➔ Comments are welcomed and may be sent by 30 June 2010 to Jeffrey Owens, Director, CTPA (jeffrey.owens@oecd.org). Unless otherwise requested at the time of submission, comments submitted to the OECD in response to this invitation will be posted on the OECD website. These Guidelines should be regarded as provisional because of the potential need to revisit some aspects in the light of future work. For further information, please feel free to contact the OECD Consumption Taxes Unit at david.holmes@oecd.org, stephane.buydens@oecd.org or alain.charlet@oecd.org

only three different countries in this example but nevertheless the conclusions would remain the same (place of taxation in Country A for the supply to A1, place of taxation in Country B for the supply to A2 and place of taxation in Country C for the supply to A3) should B1, B2 and B3 be located in countries X, Y and Z whereas A1, A2 and A3 remain respectively located in countries A, B and C (see Figure 2).

The cash flows between A1 and its subsidiaries and between B1 and its subsidiaries are consideration for services supplied under the business agreements but do not in themselves create additional supplies, nor alter the suppliers, nor identify the customer or customer location.

In principle, applying the Main Rule should not be influenced by circumstance where the supplier:

- supplies a customer who supplies onwards the services to a third party;
- renders the services to a third party that is not the customer under the business agreement; or
- is paid by a third party that is not the customer under the business agreement.

The status of the Guidelines

The draft Guidelines should be considered as a draft living document. They are released for the

purposes of inviting comments from interested parties but do not necessarily reflect the final views of the OECD and its member countries. The Committee, through its Working Party 9 (comprising senior VAT policy officials from OECD member countries) on Consumption Taxes and the Working Party's Technical Advisory Group (consisting of government, academic and business representatives), will work on the development of further Guidelines on enterprises with multiple locations and will deal with artificial avoidance and minimisation issues later. It will also consider appropriate exceptions to the Main Rule.

The draft Guidelines, when final, should be considered as 'soft law'. Although not having legal force, they include principles that should be followed by OECD member countries. The Guidelines should be persuasive on governments to make changes in their legislation as necessary. They should be limited to invoice-credit VAT/GST systems and should not relate to other types of consumption taxes. It is hoped that the Guidelines will influence the development of VAT/GST legislation in non-OECD economies.

The views expressed in this article are those of the author and should not be taken as representing the position of the OECD nor of Landwell & Associés. ■



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