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FEATURED PERSPECTIVES

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In 2010-2011, the OECD celebrates its 50th anniversary. Over the last half-century, the OECD has demonstrated its ability to act as a forum in which both member and nonmember countries can work together to share experiences and seek solutions to common problems, including in the tax area.

The OECD Model Tax Convention on Income and on Capital and its commentaries are well known as the major tools for dealing with international aspects of direct taxes. More recently, the interaction between countries' VAT[1] systems has come under greater scrutiny, as this tax now brings 20 percent of tax revenue (or more) in many of the 150 countries where it is implemented.[2] As a result the OECD is now developing its international guidelines on VAT and the goods and services tax to bring greater cohesion and consistency between countries' approaches to taxation of international trade. By so doing, greater certainty will be provided for both governments and businesses and the incidence of double taxation (and unintended double nontaxation) will be minimized. This is particularly the case with trade in services and intangibles. Draft OECD VAT/GST guidelines on the place of taxation of internationally traded services or intangibles were released for public consultation in February 2010[3] and received positive comments. Draft guidelines on neutrality published on the OECD website on December 22, 2010, completed this previous release.

Historically, this work has its roots in 2006 when the OECD's Committee on Fiscal Affairs approved the principle that except when explicitly allowed for in legislation, the economic burden of VAT should not fall on business. This supports the wider fundamental concept of VAT in that it should be neutral in its application, with the economic burden falling on household consumption.

Many businesses have expressed concerns about the difficulties of recovering VAT incurred in jurisdictions in which they are not registered (nor required to be

[1]Some countries cite their form of value added tax as a goods and services tax. For ease of reading, we refer in this article to all value added taxes as VAT.

[2]Stéphane Buydens, *Consumption Tax Trends* (2010), OECD (to be issued in February 2011).

[3]Those draft guidelines have been commented on by Alain Charlet in ''VAT Focus: Draft OECD VAT/GST Guidelines,'' *Tax J.*, Mar. 22, 2010, *available at* http://www.oecd.org/dataoecd/23/33/45274124.pdf.

registered) for VAT, which often conflicts with the neutrality of the tax.[4] To assess the extent of this problem, the OECD conducted surveys of governments and businesses[5] between 2007 and 2009. A report on the outcomes of these surveys was published on the OECD website in February 2010.[6]

Outcomes of the OECD Surveys

The 2007 government survey showed that although OECD countries have generally implemented procedures to relieve foreign businesses (either fully or partly) from local VAT, the compliance burdens are significant. This was confirmed by a business survey conducted in 2008 that showed that refund of foreign VAT is a major issue for businesses.

A second business survey in 2009 provided some solid data to measure the extent of these difficulties. This survey attracted responses from more than 300 businesses in OECD and non-OECD countries from Europe, North and South America, Asia, Africa, and Oceania. It revealed that more than 80 percent of business respondents incur expenditures in foreign countries and that almost 95 percent of them incur VAT on these. Amounts are substantial: Over 80 percent of respondents incur more than $10,000 per year and over 25 percent incur more than $1 million per year.

More than 70 percent of businesses surveyed said that they found VAT relief procedures ''difficult.'' More than 20 percent were unable to recover any foreign VAT. Half of the respondents recover 50 percent or less of the foreign VAT they incur, and a quarter recover less than 25 percent.

Key factors seem to be communication with the authorities (including guidance, forms, and procedures) and speed of repayment. Indeed, more than 55 percent of businesses outsource their foreign VAT recovery, citing local language as well as cost efficiency as the main factors.

Over one-third of businesses said that these difficulties influence decisions on investment, and nearly 40 percent have implemented legitimate alternatives to avoid incurring irrecoverable VAT and dealing with the necessary refund procedures.

Businesses would like to see improved communication with tax administrations and greater harmonization and standardization of the procedures in order to speed up and improve repayment systems.

Following these surveys, OECD countries agreed to work on ways in which countries can improve their VAT relief methods and procedures while ensuring that there are proper safeguards against fraud. As a first step, draft guidelines on neutrality were published on the OECD website in December 2010 for public consultation, with a deadline of March 23, 2011, for comments.[7]

These guidelines are based on three main principles:

- foreign businesses should be neither disadvantaged nor advantaged compared with domestic businesses in the jurisdiction where VAT is due or paid;
- governments may choose from a number of approaches to implement this principle in practice; and
- when specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden.

Nondiscrimination Principle

VAT relies on a staged collection mechanism. Successive taxpayers are entitled to deduct input tax on purchases and must account for output tax on sales. In the end, the tax collected by tax authorities through this supply chain should equal the VAT paid by the final consumer to the last vendor.

Therefore, VAT is neutral toward trade, as the burden of VAT is normally not borne by business but ultimately paid by the final consumer. The neutrality of VAT toward international trade is ensured by the destination principle. According to this principle, exports are normally exempt from VAT and imports are normally subject to VAT. This ensures neutrality in the country of import since imported and domestic supplies are taxed on the same basis and at the same rate.

[4]Alain Charlet and Stéphane Buydens, ''VAT and GST refunds: toward more business friendly-mechanisms?'' *Tax J.*, Mar. 9, 2009, *available at* http://www.oecd.org/dataoecd/34/16/42945441.pdf.

[5]Many businesses involved in international trade incur VAT in jurisdictions where they are unable to exert their right to deduction of input tax through standard domestic VAT rules. This is generally because these businesses are not carrying out any taxable activity or are not established in the country where VAT was incurred. The Committee on Fiscal Affairs' Working Party on Consumption Taxes agreed in 2007 that information should be collected on the magnitude and nature of the issues with which business and tax administrations are confronted, with a view to assessing whether these issues are significant enough to require remedies. At the same time, information regarding best practices has also been collected. Separate questionnaires were sent to tax administrations and businesses. The surveys focused on how the procedures actually work in practice rather than on how they are set out in legislation.

[6]''VAT/GST Relief for Foreign Businesses: The State of Play. A Business and Government Survey,'' Feb. 2010, *available at* http://www.oecd.org/document/47/0,3343,en_2649_33739_44560815_1_1_1_1,00.html.

[7]Comments are welcomed and may be sent by March 23, 2011, to Jeffrey Owens, director, Centre for Tax Policy and Administration (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.

Neutrality is also achieved in the country of export, as export allows deduction of the VAT paid on the supplies regarding this export. This way, the input/output VAT chain is not broken and VAT does not affect the competitiveness of domestic firms to export. This also ensures that there is only one place of taxation, and that in the end, all revenue accrues to the jurisdiction where the supply to the final consumer occurs.

However, in the real world, when businesses are purchasing supplies in jurisdictions where they are not established or required to be registered for the purpose of a taxable activity, this neutrality principle may be jeopardized. The lack, or complexity, of refund (or equivalent) mechanisms may generate a cost in terms of cash flow or — in the worst-case scenario — a VAT cost.

This distorts competition between foreign and domestic businesses. Foreign businesses not registered in the country of the purchase should not suffer a VAT cost while domestic businesses are normally able to recover this VAT. Neutrality is an important pillar of the VAT system. Therefore, the first guideline states, ''The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.''[8] The words ''except where explicitly provided'' acknowledge that there are specific circumstances when VAT may not be recoverable. This happens, for example, when businesses are carrying out an exempt activity, or when businesses purchase supplies not wholly used for furtherance of taxable activity or when explicit administrative obligations are not met.

The immediate consequence of Guideline 1 is that ''businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation'' (Guideline 2) and that ''VAT rules should be framed in such a way that they are not the primary influence on business decisions'' (Guideline 3). Therefore, ''With respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid'' (Guideline 4).

The combination of these guidelines explicitly confirms, in OECD language, the ''nondiscrimination principle.''[9] VAT systems should be applied in such a way to ensure that there is no unfair competitive advantage awarded to domestic businesses. Domestic legislation should not discriminate against foreign businesses' right to deduction or recovery of VAT as this could distort competition and business decisions may not always be made on the basis of market considerations.

Country Approaches

When implementing this nondiscrimination principle, Guideline 5 recognizes that each country may have its own approach. It says, ''To ensure foreign businesses do not incur irrecoverable VAT, governments may choose from a number of approaches.'' This means that the guidelines do not see a single ''right'' approach to be taken by governments.

The approaches that are available include direct refunds of VAT incurred (approach 1), refunds through local VAT registration (approach 2) or locally registered third parties (approach 3), zero rating supplies to foreign nonregistered businesses (approach 4), and the granting of VAT exemption certificates (approach 5). Countries may choose to use a combination of these approaches as long as the end result ensures that foreign businesses do not incur irrecoverable VAT. The key is to find the right balance between compliance costs for businesses and administrative costs for tax authorities and the need to combat tax avoidance and fraud.

Within the OECD, most member countries use direct refund procedures. This is not really surprising as 22 of the 34 OECD countries are member states of the EU. In the EU, the refund mechanism for non-EU businesses is based on the 13th VAT Directive (86/560/EEC of Nov. 17, 1986). Normally businesses that incur VAT in connection with their business activity in a member state in which they are not required to register for VAT (because normally they do not make supplies of goods or services for which they are liable for the tax) are entitled to obtain the refund of this VAT. They have to go through a refund procedure (OECD's approach 1). This requires that they complete the relevant claim forms and provide the originals of the invoices or import documents. Some member states require that these businesses appoint a tax representative for the purpose of completing the claim. This tax representative may be jointly liable with the claimant.[10] In some countries, the VAT refund may be conditional on reciprocal arrangements with the country in which the

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[8]This principle was approved by the OECD Committee on Fiscal Affairs in January 2006.

[9]Article 24 of the OECD model tax treaty already deals with the elimination of tax discrimination in specific circumstances. It provides that persons who are nationals or residents of a contracting state will not be subjected in another contracting state to any taxation or requirement that is different or more burdensome than the taxation and connected requirements to which nationals of the other contracting state are or may be subjected. Paragraph 6 of article 24 expressly provides that this provision is not limited by article 2 of the model tax treaty. Article 2 lists the taxes covered by the treaty. It includes all taxes on income and on capital including taxes on gains from the alienation of movable

(Footnote continued in next column.)

or immovable property, taxes on the total amount of wages or salaries paid by enterprises, and taxes on capital appreciation — but excludes VAT. Article 24, on the other hand, applies to taxes of every kind and thus applies to VAT.

[10]Article 2(3) of Directive 86/560/EEC of November 17, 1986, allows member states to require the appointment of a tax representative.

claimant is established.[11] The draft guidelines recognize that some tax administrations may make reference to reciprocity when setting norms for refunds. This issue will be considered later as reciprocity does in effect ''blacklist'' businesses established in some countries.

VAT systems should be applied in such a way to ensure that there is no unfair competitive advantage awarded to domestic businesses.

Outside the EU, a variety of approaches are used. In New Zealand, neutrality is achieved by zero rating a wide range of supplies when they are made to nonresidents (approach 4).[12] When supplies are not covered by the zero rating provisions, nonresident businesses are allowed to register for GST (under specific conditions; that is, they make supplies in New Zealand) and recover the tax through normal filing of a GST return (approach 2).[13] GST registration is normally available even though supplies in New Zealand are minimal since there is no de minimis limit. In practice, this creates an incentive for foreign business to develop a small taxable activity in New Zealand in order to offset its New Zealand input tax.

In Australia nonresident businesses are required to register in the country to recover the locally charged GST. However, this system will be amended effective July 1, 2011, to reduce the administrative burdens on nonresident businesses. The change results from a recent report by the Australian Board of Taxation reviewing the application of GST to cross-border transactions,[14] which explicitly mentions the OECD work in this area. The government decided against a direct refund scheme but agreed to significantly reduce the number of nonresidents with no business presence in Australia interacting with the GST regime. This will be done by excluding more business-to-business transactions from GST and by greater use of the reverse charge mechanism.

Canada also relies on zero rating to provide relief to foreign businesses when appropriate (approach 4). When GST is charged, specific rules allow nonresident businesses to register in Canada (approach 2),[15] or to require a third party that is a Canadian GST-registered business to offset the input GST or be responsible when GST is not paid (approach 3).[16]

Morocco zero rates many goods or services supplied to nonresidents (approach 4). Also, specific VAT exemption provisions allow some nonresident businesses in the cinema and television industries to purchase supplies free of VAT that would have otherwise been subject to Moroccan VAT. For instance, supplies of goods or services to foreign film companies making a film in Morocco are exempt from VAT.[17] A similar exemption applies to supplies made to companies prospecting for oil.[18]

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[11]This is an option given to EU member states by article 2(2) of Directive 86/560/EEC of November 17, 1986.

[12]Articles 11 and 11A of the New Zealand Goods and Services Tax Act. *See* http://www.legislation.govt.nz/act/public/1985/0141/latest/DLM81035.html.

[13]According to article 51(2) of the New Zealand Goods and Services Tax Act referred to by the New Zealand Inland Revenue notice (IR 365, dated Oct. 2010, *available at* http://www.ird.govt.nz/resources/c/c/cc6367004bbe58f680c9d0bc87554a30/ir365.pdf), businesses that carry out a taxable activity or intend to carry out a taxable activity and that have a turnover of less than NZD 60,000 are allowed to register voluntarily for GST.

[14]The Board of Taxation, Report to the Assistant Treasurer, Feb. 2010, *available at* http://www.taxboard.gov.au/content/reviews_and_consultations/gst_to_cross_border_transactions/report/gst_cross_border_transactions_report.pdf.

[15]According to the Canada Revenue Agency notice (''Guide RC4027, Doing Business in Canada — GST/HST Information for Non-Residents,'' *available at* http://www.cra-arc.gc.ca/E/pub/gp/rc4027/rc4027-10e.pdf), nonresident businesses that do not carry on business in Canada do not normally have to register for GST/harmonized sales tax in Canada. However, they may decide to register voluntarily for GST/HST in Canada if they purchase supplies of goods delivered in Canada or services or intangibles used or performed in Canada in the ordinary course of carrying on business outside Canada. By registering, these nonresident businesses can claim back the Canadian input tax incurred on those supplies.

[16]According to the CRA notice (''Guide RC4027, Doing Business in Canada — GST/HST Information for Non-Residents,'' *available at* http://www.cra-arc.gc.ca/E/pub/gp/rc4027/rc4027-10e.pdf), unregistered nonresidents that import goods into Canada and cannot claim back the input GST/HST on the import (because they are not registered) and that sell the imported goods to a Canadian GST/HST registrant are allowed to pass on the input tax to the Canadian registrant, provided they give the Canadian registrant sufficient proof that the import GST/HST was paid. (See ''Flow-through of Input Tax Credits,'' p. 11 of the Guide RC4027.)

Another rule allows unregistered nonresidents that obtain goods from a supplier in Canada and deliver these goods to a third party in Canada to arrange for the supplier to have the goods ''drop-shipped'' to the third party in Canada. This third party may be a customer of the unregistered nonresident. This way, no GST/HST is charged to the nonresident who is also relieved of the obligation to pay the GST/HST on the subsequent supply. (See the ''drop-shipments'' rule, p. 28 of the Guide RC4027.) The third party will provide the Canadian supplier with a drop shipment certificate in which it assumes liability to pay or remit any GST/HST that may become payable.

[17]Moroccan Code Général des Impôts, article 92 I. 38°.

[18]Moroccan Code Général des Impôts, article 92 I. 40°.

Equal Administrative Treatment

The previous examples show how countries can choose from a variety, or a combination, of approaches when ensuring that VAT is not a cost for foreign businesses. However, these approaches should strike a balance between compliance costs for businesses, protection of governments against fraud, and VAT administration costs for tax authorities.

Guideline 6 says, ''Where specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses.'' This means that specific rules applicable to foreign businesses should not result in a disguised form of discrimination.[19] Equally, VAT refund or relief mechanisms should not involve disproportionate costs or burdens on the tax administration. This might happen with frequent low-value claims.

However, because dealing with foreign businesses with no legal presence in a jurisdiction inevitably brings an element of risk for tax administrations, the draft guidelines also recognize that tax administrations may take measures to protect against fraud or avoidance, although these measures should be balanced against the need to avoid unjustified discrimination.

Clearly, the problem for tax authorities when dealing with foreign businesses is the lack of presence of these businesses on their national territory. This is even more sensitive when these administrations have to refund VAT to these foreign businesses. The absence of jurisdictional power over foreign businesses, or the lack of efficient exchange of information and mutual assistance procedures between countries, may leave tax administrations exposed to fraudulent claims with little hope of recovering any incorrect refund payments. Because of this lack of presence, tax administrations cannot rely on their usual means of control and may choose therefore to implement stricter procedures to protect themselves. If, however, tax authorities have appropriate tools that allow them to exchange information, this may result in simpler and less burdensome rules for businesses.

Exchange of information provisions already exist in the OECD model treaty,[20] in tax information exchange agreements,[21] and in joint initiatives with the Council of Europe.[22] Exchange of information and mutual assistance provisions were also recently reinforced within the EU.[23] Tax administrations should therefore be encouraged to take full advantage of these instruments that support exchange of information and mutual assistance in debt recovery in order to relieve businesses from burdensome compliance procedures.

Next Steps and Future of the Guidelines

The draft guidelines on neutrality should be considered as a 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. They might be expanded and modified as the work moves forward.

These guidelines, when final, should be considered ''soft law.'' Although not having legal force, they include principles that should be followed by OECD member countries. They should be persuasive on governments to make changes in their legislation as necessary.[24]

The OECD Committee on Fiscal Affairs, through its Working Party 9 on Consumption Taxes (comprising

[19]Within the EU — but this might be transposable to VAT refund claims submitted by non-EU businesses — the European Court of Justice decided that a member state (Germany) could not require that the EU taxable person who is asking for the refund of VAT incurred in another member state (while he is not established in this member state or is not carrying out a taxable activity in this member state for which he has to register for VAT) should sign the refund claim (ECJ, *Yaesu Europe BV*, C-433/08, Dec. 3, 2009). According to the Court, a refund application does not necessarily need to be signed by the taxable person in person. The signature of an agent may be sufficient. In this context, the requirement for a signature by the taxable person itself could be perceived as an example of a disproportionate administrative burden on a foreign business. Within the EU, the relatively recent implementation of the electronic VAT refund procedure by Directive 2008/9/CE, dated Feb. 12, 2008, has suppressed as from January 2010 the obligation to sign VAT refund claims. The goal is to enhance the position of businesses, as the former paper-based procedure was perceived as being slow, cumbersome, and costly. (See the European Commission's website, at http://ec.europa.eu/taxation_customs/taxation/vat/traders/vat_refunds/index_en.htm.)

[20]Article 26 of the OECD model treaty was extended in 2000 to allow for the exchange of information for both direct and indirect tax purposes. Thus, a number of bilateral tax treaties include exchange of information for tax purposes. Article 26 allows for automatic and spontaneous exchange of information.

[21]TIEAs allow for the exchange on request of foreseeable, relevant information.

[22]The joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters provides for exchange of information on all taxes. The 15 countries (Denmark, Finland, France, Iceland, Italy, Korea, Mexico, the Netherlands, Norway, Portugal, Slovenia, Sweden, Ukraine, the United Kingdom, and the United States) that are already parties to the convention can exchange VAT information under this instrument.

[23]The Council of the European Union reached political agreement on December 7, 2010, on a draft directive aimed at strengthened mutual assistance between member states to better combat tax evasion and fraud (Press: 279 Nr: 15094/10). The draft directive should ensure that the OECD standard for the exchange of information on request is implemented in the EU and should also extend cooperation between member states to cover taxes of any kind.

[24]The guidelines 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.

senior VAT policy officials from OECD member countries) and the working party's technical advisory group (consisting of government, academic, and business representatives), will develop the guidelines further, including in the area of the reduction and treatment of cases of double taxation and unintended nontaxation.

The OECD international VAT/GST guidelines will be accompanied by more practical guidance and best practices (for example, through its Consumption Tax Guidance Series[25]). Such guidance and best practices will take the results of the 2009 business survey, in which respondents stressed the need for clearer, more consistent, and more accessible procedures for foreign businesses, into account. For instance, the survey revealed that the use of a local language is the main factor that drives businesses to outsource the management of their foreign VAT refund claim.[26] Consideration of electronic invoicing and use of electronic procedures were also mentioned by businesses as potential improvements. This guidance and these best practices should strike a balance between compliance costs for businesses, protection of governments against fraudulent claims, and VAT administration costs for tax authorities. Would, for instance, simpler procedures allow for quicker repayments while allowing tax administrations to reallocate resources to high-risk areas?

Building on its 50-plus years of experience in direct taxes, the OECD is now developing its expertise in consumption taxes through its VAT/GST guidelines. Its ability to connect business and governments, so important in the VAT area, ensures that it is the leading forum for developing such guidance. ◆

[25] *See* already published entries of the Consumption Tax Guidance Series at http://www.oecd.org/ctp/ct, under ''Publications & Documents/Guidelines.''

[26] *Supra* note 6, para. 110.