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# A Hitchhiker's Guide to the OECD's International VAT/GST Guidelines

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# FLORIDA TAX REVIEW

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## A HITCHHIKER'S GUIDE TO THE OECD'S INTERNATIONAL VAT/GST GUIDELINES

By

Walter Hellerstein \*

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## I. INTRODUCTION

The OECD's International VAT/GST Guidelines,<sup>1</sup> which were released in their consolidated form at the OECD's Global Forum on VAT in Paris in late 2015,<sup>2</sup> are the culmination of nearly two decades of efforts to provide internationally accepted standards for consumption taxation<sup>3</sup> of cross-border trade, particularly trade in services and intangibles.<sup>4</sup> For an American tax journal, however, even one that regularly publishes articles addressed to international taxation,<sup>5</sup> an article on VAT may seem to be an odd choice of a

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1. OECD, INTERNATIONAL VAT/GST GUIDELINES (2015) [hereinafter OECD, VAT/GST GUIDELINES]. A number of countries, including Australia, Canada, and New Zealand, refer to their value added taxes (VATs) as goods and services taxes (GSTs). For ease of reading, throughout the ensuing discussion (as throughout the OECD's Guidelines), the term VAT is generally used to describe all VATs, however denominated. It is worth noting at the outset that the Guidelines comprise not only individual, numbered Guidelines, but also consideration of general VAT principles, explanations of individual Guidelines, and extensive commentary and other guidance, which I refer to collectively throughout this Article as the Guidelines. References to individual Guidelines are identified by a number following the word Guideline (e.g., Guideline 2.1).

2. Third Meeting of the OECD Global Forum on VAT, OECD (Nov. 5–6, 2015), <http://www.oecd.org/ctp/consumption/vat-global-forum.htm>.

3. For purposes of the ensuing discussion, the term “consumption tax” is used to mean broad-based taxes that are designed, at least in principle, to reach “final” or “household” consumption. The Guidelines reflect the same understanding. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 1.2, at 11 (“The overarching purpose of a VAT is to impose a broad-based tax on consumption, which is understood to mean final consumption by households.”).

4. There are many ways in which one can divide or subdivide the world of trade for VAT and other purposes. The EU VAT, for example, divides the entire universe of trade into trade in “goods” and trade in “services,” with a “supply of services” defined as “any transaction which does not constitute a supply of goods.” Council Directive 2006/112, of 28 November 2006 on the Common System of Value Added Tax, art. 24(1), 2006 O.J. (L 347) 1, 14 (EC) (as amended) [hereinafter EU VAT Directive]. Other jurisdictions have categories of supplies other than goods and services, such as intellectual property rights and other intangibles, which I (in accord with the usage in the Guidelines), refer to collectively as “intangibles.” OECD, VAT/GST GUIDELINES, *supra* note 1, para. 11, n.2 at 10.

5. See, e.g., Yariv Brauner, *What the BEPS?*, 16 FLA. TAX REV. 55 (2014) [hereinafter Brauner, *What the BEPS?*]; Jane G. Gravelle, *International Income Tax Reform*, 9 FLA. TAX REV. 469 (2009); H. David Rosenbloom et al., *The Unruly World*

topic. After all, American exceptionalism continues to inform national tax policy, leaving the United States as the only country in the OECD (and among the overwhelming majority of countries worldwide) without a VAT.<sup>6</sup> Nor does the United States have any other general consumption tax as part of its national tax structure. Moreover, even if one takes the liberty of describing the American subnational retail sales tax (RST) as a consumption tax,<sup>7</sup> there are significant structural differences between the American single-stage RST and the multiple-stage collection process that defines the VAT, thus limiting the relevance of many VAT issues to the American consumption tax regime. Finally, and perhaps most fundamentally, there is the perception in international tax circles that the problems associated with income taxes are intellectually more challenging and thus more worthy of attention than those associated with VATs—problems that are often viewed as involving little more than cash-flow management.<sup>8</sup> Indeed, one need look no further than the

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*of Tax: A Proposal for an International Tax Cooperation Forum*, 15 FLA. TAX REV. 57 (2014).

6. OECD, CONSUMPTION TAX TRENDS 2014: VAT/GST AND EXCISE RATES, TRENDS AND POLICY ISSUES 18, annex B (2014), <http://dx.doi.org/10.1787/ctt-2014-en> [hereinafter OECD, CONSUMPTION TAX TRENDS 2014]. The OECD lists 164 countries with VATs. Although there are disagreements as to the precise number of countries that exist in the world, according to Wikipedia “the United Nations system divides the 206 listed states into three categories: 193 member states, two observer states, and 11 other states.” *List of Sovereign States*, WIKIPEDIA, [https://en.wikipedia.org/wiki/List\\_of\\_sovereign\\_states](https://en.wikipedia.org/wiki/List_of_sovereign_states) (last visited on January 13, 2016).

7. In fact, roughly 40 percent of the American RST base constitutes business purchases rather than household consumption, the theoretically appropriate base of a consumption tax. 2 JEROME R. HELLERSTEIN, WALTER HELLERSTEIN & JOHN SWAIN, STATE TAXATION ¶ 12.03 (3d ed. 2016 rev.) [hereinafter HELLERSTEIN, STATE TAXATION TREATISE] (citing John Mikesell, *The Disappearing Retail Sales Tax*, 63 STATE TAX NOTES 777, 781 (Mar. 5, 2012) (estimating that median share of total sales tax base represented by business purchases is 41.1 percent)); Robert Cline et al., *Sales Taxation of Business Inputs: Existing Tax Distortions and the Consequence of Extending the Sales Tax to Business Services*, 35 STATE TAX NOTES 457 (Feb. 14, 2005); Raymond Ring, *Consumers' Share and Producers' Share of the General Sales Tax*, 52 NAT'L TAX J. 79 (1999); Raymond Ring, *The Proportion of Consumers' and Producers' Goods in the General Sales Tax*, 42 NAT'L TAX J. 167, 175 (1989); Alan D. Viard, *Sales Taxation of Business Purchases: A Tax Policy Distortion*, 56 STATE TAX NOTES 967 (June 21, 2010). Moreover, most household consumption involving services (as distinguished from goods) simply escapes sales taxation altogether. See HELLERSTEIN, STATE TAXATION TREATISE, *supra*, ¶ 12.05.

8. See, e.g., Andrew Stone, *Top Tips: Improve Cash Flow Through VAT*, April 27, 2015, <http://www.sage.co.uk/business-advice/legislation/vat-and-cash-flow> (“VAT is often seen as an inconvenience by many small businesses but the fact is it

OECD's Base Erosion and Profit Shifting (BEPS) Action Plan initiative as a metric of the international tax community's comparative interest in income taxes and VATs: of the fifteen Actions contemplated by the BEPS Action Plan, only Action 1 (Addressing the Tax Challenges of the Digital Economy) focuses explicitly on VAT.<sup>9</sup>

With expectations appropriately lowered as to what to expect from an article devoted to VAT issues,<sup>10</sup> I hope that what follows will, at a minimum, persuade readers that there is more to VAT than cash-flow and, with any luck, pique some interest in the challenges that VATs confront—and that the Guidelines have sought to address—with respect to international trade in services and intangibles.<sup>11</sup> Part II of this Article provides the background to the Guidelines, describing the basic features of a VAT, the problems with which the Guidelines are concerned, and a brief history of the OECD's efforts

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can actually help your cash flow. Get it right and you can be taking in VAT and holding onto it before you have to pay it back out.”).

9. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING 14–15 (2013), [http://www.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profit-shifting\\_9789264202719-en](http://www.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profit-shifting_9789264202719-en). See generally Brauner, *What the BEPS?*, *supra* note 5.

10. This approach may be viewed as a variation on the hanging-of-crepe strategy employed by physicians who offer the bleakest prediction of the patient's outcome, so that if the patient dies, it will be consistent with the family's expectations and if the patient survives, the family is exhilarated and the doctor is viewed as a hero. As a juris doctor, I stake a quasi-claim to this strategy.

11. The ensuing discussion draws freely from my (and, where pertinent, my co-author's or co-authors') work in this area including Walter Hellerstein, *Exploring the Potential Linkages Between Income Taxes and VAT in a Digital Global Economy*, in VAT/GST IN A DIGITAL GLOBAL ECONOMY 83 (Michael Lang & Ine Lejeune eds., 2015) [hereinafter Hellerstein, *Exploring the Potential Linkages*]; Walter Hellerstein, *Jurisdiction to Tax in the Digital Economy: Permanent and Other Establishments*, 68 BULL. FOR INT'L TAX'N 346 (2014) [hereinafter Hellerstein, *Permanent and Other Establishments*]; ARTHUR COCKFIELD, WALTER HELLERSTEIN, REBECCA MILLAR & CHRISTOPHE WAERZEGGERS, TAXING GLOBAL DIGITAL COMMERCE (2013) [hereinafter COCKFIELD ET AL., TAXING DIGITAL COMMERCE]; Walter Hellerstein, *Consumption Taxation of Cross-border Trade in Services in an Age of Globalization*, in GLOBALIZATION AND ITS TAX DISCONTENTS: TAX POLICY AND INTERNATIONAL INVESTMENTS 305 (Arthur Cockfield ed., 2010); Michael Keen & Walter Hellerstein, *Interjurisdictional Issues in the Design of a VAT*, in *Symposium: Structuring a Federal VAT: Design and Coordination Issues*, 63 TAX L. REV. 359 (2010) [hereinafter Keen & Hellerstein, *Interjurisdictional Issues*]; Walter Hellerstein & Harley Duncan, *VAT Exemptions: Principles and Practice*, 128 TAX NOTES 989 (Aug. 30, 2010) [hereinafter Hellerstein & Duncan, *VAT Exemptions*]; Walter Hellerstein & Timothy Gillis, *The VAT in the European Union*, 127 TAX NOTES 461 (Apr. 26, 2010) [hereinafter Hellerstein & Gillis, *VAT in the EU*].

to address these problems. Part III discusses the Guidelines' neutrality principles. Part IV discusses the general rules applicable to business-to-business (B2B) transactions. Part V discusses the general rules applicable to business-to-consumer (B2C) transactions. Part VI discusses specific rules for particular types of supplies.<sup>12</sup> Part VII discusses the Guidelines' recommendations designed to support a consistent interpretation of the Guidelines, including the use of mechanisms for mutual cooperation and exchange of information and other arrangements allowing tax administrations to work together. Part VIII concludes.

## II. BACKGROUND TO THE GUIDELINES

### A. *Basic Features of a VAT*

As we have already observed,<sup>13</sup> a VAT in principle is a broad-based tax on household consumption implemented through a staged collection process. Accordingly, a VAT should apply only to supplies to private individuals, as distinguished from businesses, because only private individuals engage in the consumption at which the VAT is directed.<sup>14</sup> Nevertheless, while the burden of the VAT should not rest on business, the VAT's staged collection process necessarily draws businesses into the VAT regime, because they act as taxpayers as well as tax collectors in intermediate, B2B transactions, and as tax collectors in final, B2C transactions.<sup>15</sup> Indeed, under

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12. VATs typically use the term "supply" and "supplier" to designate, respectively, the transaction that is potentially subject to the tax and the person effecting the potentially taxable transaction, rather than the terms "sale" and "seller," which may be more familiar to the American reader.

13. *See supra* Part I.

14. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 1.2, at 11. This is not to suggest, however, that a VAT always operates in practice the way it is supposed to operate in theory, as the ensuing discussion will make clear. For the moment, however, I ignore such complications.

15. I use the term "taxpayer" and "tax collector" not in a technical sense, but simply to distinguish between the role of the business purchaser and the role of the business seller (or supplier) in a VAT regime. The business purchaser will pay the tax included in or added to the price of goods or services sold to it by its supplier, and thus may be considered to be the "taxpayer." The supplier, who includes the tax in or adds the tax to the price charged to its business customer, remits the tax (less any applicable input tax credits) to the government, and thus may be considered to be the "tax collector." Although a business may be characterized as a "taxpayer" on its taxable purchases (inputs), it will not, in principle, bear the burden of the tax it pays because, as noted, it will receive a credit for the input tax paid against the tax that it collects on its taxable sales (outputs). Moreover, if the output tax is less than the input tax paid,

some VATs, businesses may be the *only* actors upon whom the VAT regime imposes legal obligations, because the private consumer, while paying the VAT charged to her by the business, is not taxable *under* the VAT regime.<sup>16</sup>

The central design feature of a VAT—the staged collection process whereby each business in the supply chain remits a tax on the difference between the VAT imposed on its inputs and the VAT imposed on its outputs (i.e., its “value added”), coupled with the fundamental principle that the burden of the tax should not rest on businesses, requires a mechanism for relieving businesses of the burden of the VAT they remit. The method employed by most VAT regimes is the invoice-credit method, under which the business receives a credit for the tax it pays on its purchases (input tax) against the tax that it collects on its sales (output tax).<sup>17</sup>

The invoice-credit method can be illustrated by the following example. Assume that a 10 percent VAT is applied to the production and sale of notepads. Further assume that a tree farmer, who makes no purchases,<sup>18</sup>

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the business taxpayer can recover the difference from the taxing authority in the form of a refund.

16. By contrast, in the United States, even though the registered vendor ordinarily must collect the state sales or use tax from the individual consumer, the consumer is often the legal “taxpayer” under the sales tax, HELLERSTEIN, STATE TAXATION TREATISE, *supra* note 7, at ¶ 12.01, and is *always* the legal “taxpayer” under the use tax. *Id.* at ¶ 16.01[2]. There are, however, some VAT regimes that impose a legal obligation upon individual consumers to pay and remit the tax, at least in some circumstances. *See* COCKFIELD ET AL., TAXING DIGITAL COMMERCE, *supra* note 11, at 397 n.123.

17. If the output tax is less than the input tax paid, e.g., for a start-up business or a business that exports its product (and therefore collects no tax on its sales), the business taxpayer can recover the difference from the taxing authority in the form of a refund. Although the VAT is a tax on transactions, it may be worth noting that VAT returns (like American state RST returns) are normally filed on a periodic basis (monthly, bi-monthly, or quarterly) on the basis of all relevant transactions occurring within the taxable period.

18. Hellerstein & Duncan, *VAT Exemptions*, *supra* note 11, at 989 n.4 (“This unrealistic (but harmless) assumption simply allows the VAT chain to start with the tree farmer’s sale rather than further ‘upstream’ in the economic process (i.e., suppliers who sell to the tree farmer).”).

I also assume unrealistically (but harmlessly) that the transactions described are the only transactions in which the various economic actors engage, thereby limiting the output tax and input tax credits to those generated by those transactions. Finally, it may be worth noting that the “purchase” and “sales” columns reflect a VAT-exclusive “price” to which the VAT is applied. Under most VATs, the actual sales price is VAT-inclusive, so that the tree farmer’s price to the paper mill would be \$110, the paper mill’s price to the printer would be \$165, etc. A more accurate—but for an American reader probably more confusing—table would have used the term “value” or “taxable

harvests trees and sells them to a paper mill for \$100, plus a \$10 VAT; the paper mill, in turn, produces paper that it sells to a printer for \$150, plus a \$15 VAT against which it credits the \$10 VAT it paid, remitting the \$5 balance to the government; the printer, in turn, binds and colors the paper, selling it to the retailer for \$300 plus a \$30 VAT against which it credits the \$15 VAT it paid, remitting the \$15 balance to the government; and the retailer sells the notepads to consumers for \$500 plus a \$50 VAT against which it credits the \$30 VAT it paid, remitting the \$20 balance to the government. These transactions are illustrated in the following table.<sup>19</sup>

**Invoice-Credit Method Under 10% VAT<sup>20</sup>**

	Purchases	Sales	Output Tax	Input Tax Credit	Net VAT Liability
Tree Farmer	\$0	\$100	\$10	\$0	\$10
Paper Mill	\$100	\$150	\$15	\$10	\$5
Printer	\$150	\$300	\$30	\$15	\$15
Retailer	\$300	\$500	\$50	\$30	\$20
Total					\$50

It may be worth noting in passing that the ultimate result would not be different under a RST with the same assumed facts.<sup>21</sup>

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value” for the column labeled “sales.” It also would have complicated the comparison between a VAT and a RST. *See infra* note 21.

19. The example is taken from Hellerstein & Duncan, *VAT Exemptions, supra* note 11, at 989–90.

20. The table is taken from Hellerstein & Duncan, *VAT Exemptions, supra* note 11, at 990, tbl. 1.

21. Assume that a 10 percent RST is applied to the production and sale of notepads under the same economic assumptions that governed the VAT transactions described above. The tree farmer harvests trees and sells them to a paper mill for \$100, charging no tax because he receives a “resale certificate” from the paper mill. A seller, who generally must charge RST on taxable items, is relieved of this obligation if it receives a resale certificate from the purchaser, which indicates that the item is purchased for resale. Under these circumstances, the sale is exempt from tax. *See generally* HELLERSTEIN, *STATE TAXATION TREATISE, supra* note 7, at ¶ 14.02. The paper mill, in turn, produces paper that it sells to a printer for \$150, again charging no tax because it receives a resale certificate from the printer. The printer, in turn, binds and colors the paper, selling it to the retailer for \$300, again charging no tax because it receives a resale certificate from the retailer. Finally, the retailer sells the notepads to consumers for \$500 plus a \$50 RST, which it remits to the government. These transactions are illustrated in the following table.

The basic design of the VAT with tax imposed at every stage of the economic process, but with a credit for taxes on purchases by all but the final consumer, gives the VAT “its essential character in domestic trade as an economically neutral tax.”<sup>22</sup> As the introductory chapter to the Guidelines explains:

The full right to deduct input tax through the supply chain, except by the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain, and the means used for its delivery (*e.g.* retail stores, physical delivery, Internet downloads). As a result of the staged payment system, VAT thereby “flows through the businesses” to tax supplies made to final consumers.<sup>23</sup>

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**Application of 10% RST to Facts of VAT Example**

	Purchases	Sales	Output (Sales) Tax	Input Tax Credit	Sales Tax Liability
Tree Farmer	\$0	\$100	\$0 (exempt sale for resale)	Not Applicable	\$0
Paper Mill	\$100	\$150	\$0 (exempt sale for resale)	Not Applicable	\$0
Printer	\$150	\$300	\$0 (exempt sale for resale)	Not Applicable	\$0
Retailer	\$300	\$500	\$50	Not Applicable	\$50
Total					\$50

The demonstration of the equivalence between these two sets of transactions under an ideal VAT and RST is hardly original. *See, e.g.,* Sijbren Cnossen, *A VAT Primer for Lawyers, Economists, and Accountants*, 55 TAX NOTES INT’L 319 (July 27, 2009) (table demonstrating equivalence of taxation between various forms of consumption tax, including VAT and RST).

22. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 1.7, at 12.

23. *Id.*

B. *The VAT and International Trade*

1. *The Destination Principle*

The Guidelines, of course, are addressed to *international* trade, which raises a host of additional questions regarding the design of a VAT if “its essential character . . . as an economically neutral tax” is to be maintained.<sup>24</sup> The threshold question in this regard is whether the levy should be imposed by the jurisdiction of origin or destination. Under the destination principle, tax is ultimately levied only on the final consumption that occurs within the taxing jurisdiction. Under the origin principle, the tax is levied in the various jurisdictions where the value was added.<sup>25</sup>

There are theoretical economic arguments that can be advanced in favor of either the destination or the origin principle,<sup>26</sup> with the former placing all firms competing in a given jurisdiction on an even footing and the latter placing consumers in different jurisdictions on an even footing. When it comes to the question of the choice between these two principles, however, “economic theory . . . gives a reasonably clear answer,” namely, that “the destination principle is noticeably the more attractive.”<sup>27</sup> As the Guidelines observe:

The application of the destination principle in VAT achieves neutrality in international trade. Under the destination principle, exports are not subject to tax with refund of input taxes (that is, “free of VAT” or “zero-rated”) and imports are taxed on the same basis and at the same rates as domestic supplies. Accordingly, the total tax paid in relation to a supply is determined by the rules applicable in the jurisdiction of its consumption and all revenue accrues to the jurisdiction where the supply to the final consumer occurs.<sup>28</sup>

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24. *Id.*

25. The preceding two sentences are taken verbatim from the introductory chapter to the Guidelines. *Id.* para. 1.8, at 12. I omitted quotation marks to avoid the impression that there is anything noteworthy about the Guidelines’ statement of these principles.

26. See Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 360–66. I do not rehearse the competing arguments here, but they are set forth in the aforementioned article.

27. *Id.* at 362.

28. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 1.9, at 12. It may be worth noting that there is more than one way of implementing the destination

Moreover, the destination principle is the norm in international trade, is sanctioned by World Trade Organization Rules,<sup>29</sup> and reflects rules generally in force under most existing VATs. Accordingly, the Guidelines, in accord with the widespread international consensus, embrace the destination principle as the basic rule for application of the VAT to international trade.

## 2. *Implementing the Destination Principle*

### a. *Trade in Goods*

Adoption of the destination principle as a theoretical norm for taxing consumption is just the starting point for applying VAT to international trade in a consistent manner that avoids the risk of double taxation and unintended non-taxation, at least in an economy that is increasingly characterized by trade in services and intangibles, which is the focus of the Guidelines. *Implementing* that principle, i.e., adopting practical place-of-taxation rules that identify the jurisdiction in which final consumption occurs, raises a host of additional questions because identification of the jurisdiction in which final consumption occurs can be effectuated only through proxies that reflect one's "best guess" where final consumption is likely to occur since "in many (if not most) cases consumption is not directly observable."<sup>30</sup>

Implementing the destination principle with respect to cross-border trade in goods is relatively straightforward, based on the assumption that the destination of goods determined by physical flows is a reasonable proxy for where consumption of the goods is likely to occur. Accordingly, when the seller of goods is in one jurisdiction and the purchaser is in another, the goods are generally taxed where they are delivered. To accomplish this goal, exported goods are commonly zero-rated<sup>31</sup> and imported goods are taxed at

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principle. Although the Guidelines describe the "standard way" of doing so, "[o]ne could also envisage, for instance, the exporting country charging tax on exports just as it does on all domestic sales, with the importing country allowing this as a credit against its own tax charge." Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 360.

29. See Agreement on Subsidies and Countervailing Measures, Marrakesh Agreement Establishing the World Trade Organization, art. I, n.1, Apr. 15, 1994, [https://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](https://www.wto.org/english/docs_e/legal_e/24-scm.pdf) ("[T]he exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.").

30. Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 367.

31. LIAM EBRILL ET AL., *THE MODERN VAT* 184 (2001) [hereinafter EBRILL ET AL., *MODERN VAT*]. Under the EU VAT, for example, if a taxable supply is zero-rated, the supplier need not collect VAT on the sale of the supply, and the supply

the border.<sup>32</sup> For the most part, border controls provide an effective mechanism for assuring collection of VATs on cross-border supplies of goods at their destination.<sup>33</sup> In addition, the implementation of the destination principle is often facilitated in the B2B context by “reverse charge” mechanisms pursuant to which registered business purchasers, who are subject to control and audit by taxing authorities at destination, self-assess the VAT.<sup>34</sup> This is currently the case for trade in goods between Member States in the EU, for instance: goods are zero-rated in the exporting Member State, and importing registered traders then account for import VAT not at the border but in their first periodic return, at which point they both charge themselves tax and claim any credit due against sales.<sup>35</sup>

This is not to suggest that the destination principle as applied to goods creates no difficulties. Zero rating of exports can lead to fraud,<sup>36</sup> causing a loss of revenue when goods that are purportedly exported are in fact sold locally and traders claim input tax refunds on the purported exports.<sup>37</sup> If border controls are not air tight, and sometimes even if they are, individual consumers can avoid the destination principle through cross-border shopping, particularly with respect to high value, easily transported goods, which they illegally (or

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is effectively relieved of VAT altogether at origin, because the supplier can obtain a credit or refund for the payment of any VAT on inputs related to its acquisition or production.

32. See Walter Hellerstein, *Jurisdiction to Tax Income and Consumption in the New Economy: A Theoretical and Comparative Perspective*, 38 GA. L. REV. 1, 28 (2003) [hereinafter Hellerstein, *Jurisdiction to Tax in the New Economy*].

33. OECD, TAXATION AND ELECTRONIC COMMERCE: IMPLEMENTING THE OTTAWA TAXATION FRAMEWORK CONDITIONS 124 (2001) [hereafter OECD, IMPLEMENTING OTTAWA TAXATION FRAMEWORK].

34. *Id.* at 30. The destination principle is technically associated only with the final consumption that is subject to tax under VAT. See, e.g., OECD, VAT/GST GUIDELINES, *supra* note 1, para. 1.8, at 12. (“Under the *destination principle*, tax is ultimately levied only on the *final consumption* that occurs within the taxing jurisdiction.” (emphasis added)). Accordingly, “[t]hat principle is therefore entirely silent on which jurisdiction should tax business-to-business (B2B) transactions,” see Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 367, because such transactions do not involve final consumption. However, as explained in more detail below, see *infra* Part IV(A), the B2B place-of-taxation rules should be designed to facilitate implementation of the destination principle, and one may be forgiven for occasionally eliding the objective of a B2C place-of-taxation rule designed to *implement* the destination principle and the objective of a B2B place-of-taxation rule designed to *facilitate implementation of* the destination principle (B2B).

35. Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 369.

36. EBRILL ET AL., MODERN VAT, *supra* note 31, at 184.

37. See INTERNATIONAL VAT ASSOCIATION, COMBATING FRAUD IN THE EU: THE WAY FORWARD (2007).

legally) bring back across the border.<sup>38</sup> Despite these difficulties, the widely accepted, if imperfect mechanisms for implementing the destination principle with respect to cross-border trade in goods are generally workable, and if international trade consisted solely of trade in goods, it is doubtful the OECD would have undertaken the task of developing the VAT/GST Guidelines.

*b. Trade in Services and Intangibles*

Implementing the destination principle is more complicated with respect to the taxation of cross-border trade in services and intangibles<sup>39</sup> than with respect to cross-border trade in goods. Part of the problem, particularly with regard to services,<sup>40</sup> is simply historical. Until fairly recently, cross-border trade in services attracted relatively little attention because most services were consumed where they were performed. Consequently, there was not much cross-border trade with respect to which a “destination” needed to be identified. The general rule in many jurisdictions—that services should be taxed where the service provider is established<sup>41</sup>—although technically an origin-based rule, in fact functioned satisfactorily as a destination-based rule, because the supplier’s location was also the customer’s location, and customer location may be viewed as a reasonable proxy for the “destination” of services.

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38. EBRILL ET AL., MODERN VAT, *supra* note 31, at 184 (“It has been estimated, for instance, that in 1986 about one-quarter of all spirits drunk in the Republic of Ireland were bought in Northern Ireland.”).

39. As I noted at the outset to this Article, *see supra* note 4, some jurisdictions divide the entire universe of trade into trade in “goods” and trade in “services” whereas others have categories of supplies other than goods and services, such as intellectual property rights and other intangibles, which I (in accord with the usage in the Guidelines) refer to collectively as “intangibles.” *See* OECD, VAT/GST GUIDELINES, *supra* note 1, para. 11 n.2, at 10.

40. For purposes of the immediately ensuing discussion, the term “services” is employed in its narrower sense to denote services that are “performed” by a “service provider,” as distinguished from the broader concept of services that would include all trade, other than trade in goods, including the licensing of intangible property. *See supra* notes 4 and 39.

41. *See, e.g.*, EU VAT Directive, *supra* note 4, art. 43 (deeming the place of supply of services, with some notable exceptions, to be “the place where the supplier has established his business or has a fixed establishment from which the service is supplied, or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides”). These rules changed in important respects on January 1, 2010 with regard to B2B supplies of services and on January 1, 2015 with respect to B2C supplies of services. *See generally* COCKFIELD ET AL., TAXING DIGITAL COMMERCE, *supra* note 11, ch. 5; Hellerstein & Gillis, VAT in the EU, *supra* note 11, at 467–71.

This state of affairs changed dramatically with the enormous growth in cross-border trade in services, driven by forces of globalization and facilitated by technological innovation. With the increasing “disconnect” between performance and consumption or use of services in a territorial sense,<sup>42</sup> the traditional rule for determining the place of taxation of services by reference to the service provider’s establishment becomes problematic. The problem was exacerbated by the growth of multinational corporations, which render services in myriad locations through complicated legal structures. But the problem of designing an appropriate regime for taxing cross-border trade in services is more than the matter of recognizing that many contemporary services are in fact performed in one jurisdiction and consumed or used in another and simply adopting a destination-based rule for the place of taxation of services akin to the rule for the place of taxation of goods.

The more fundamental problem is that the enormous growth in services involving suppliers in one jurisdiction and customers in another often involves services that are intangible in nature, making it more difficult both to determine the appropriate jurisdiction of “destination” and to enforce the tax on the basis of that determination, because such services are not amenable to border controls in the same manner as goods.<sup>43</sup> Such intangible services, which may be somewhat circularly defined as services “where the place of consumption may be uncertain,”<sup>44</sup> or, perhaps a bit more precisely, as “services and intangible property that are capable of delivery from a remote location,”<sup>45</sup> include services such as “consultancy, accountancy, legal and other ‘intellectual’ services; banking and financial transactions; advertising; transfers of copyright; provision of information; data processing; broadcasting; and telecommunications services.”<sup>46</sup>

In short, the foregoing challenges raised by cross-border trade in services and intangibles are the *raison d'être* of the OECD’s VAT/GST Guidelines.

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42. Indeed, even the place of performance may be uncertain, as when the warranty of a U.S. resident’s computer is fulfilled by a technician in Bangalore who takes electronic control of her laptop and resolves the problem through key strokes performed 8,000 miles away.

43. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 1.14, at 13.

44. OECD, IMPLEMENTING OTTAWA TAXATION FRAMEWORK, *supra* note 33, at 24.

45. OECD COMM. ON FISCAL AFFAIRS, *Consumption Taxation of Cross-Border Services and Intangible Property in the Context of E-Commerce* (2001) [hereinafter OECD, *E-Commerce Guidelines*], reproduced in OECD, IMPLEMENTING OTTAWA TAXATION FRAMEWORK, *supra* note 33, at 44.

46. OECD, IMPLEMENTING OTTAWA TAXATION FRAMEWORK, *supra* note 33, at 25.

C. *A Brief History of the OECD's Initiative to Develop VAT/GST Guidelines*

The seeds of the OECD's interest in developing guidelines for consumption taxation of cross-border trade in services and intangibles<sup>47</sup> were sown in the OECD's concerns over the impact of electronic commerce on international cross-border taxation, both direct and indirect.<sup>48</sup> Evidence of these concerns can be traced to a conference organized by the OECD's Committee on Fiscal Affairs (CFA)<sup>49</sup> in Turku, Finland, in November 1997,<sup>50</sup> and a round table discussion document entitled "Electronic Commerce: the challenges for state tax authorities."<sup>51</sup> The Turku conference led to an OECD meeting at the ministerial level the following year in Ottawa, entitled "A Borderless World—Realising the Potential of Electronic Commerce,"<sup>52</sup> at which the CFA presented its seminal report, *Electronic Commerce: Taxation Framework Conditions*.<sup>53</sup> Among other things, this report delineated the overarching principles that should inform the development of rules to govern consumption taxes in the electronic age:

- Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction

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47. Indeed, one might broaden the statement to embrace the OECD's interest in consumption taxation generally, as it was not until 1999 that the OECD, motivated by the developments described immediately below, established its Working Party No. 9 on Consumption Taxation.

48. I trace the history of these developments only briefly here. For a more detailed and systematic discussion of this history, see COCKFIELD ET AL., *TAXING DIGITAL COMMERCE*, *supra* note 11, ch. 5.

49. The OECD's CFA is the OECD body charged with overseeing the OECD's work on tax issues and comprises representatives of OECD member countries and countries with "observer" status at the OECD. See OECD, *CURRENT TAX AGENDA 2012*, at 6 (2012), [www.oecd.org/tax/OECDCurrentTaxAgenda2012.pdf](http://www.oecd.org/tax/OECDCurrentTaxAgenda2012.pdf). Within the OECD's organizational framework, the CFA lies just below the Council, a body comprising representatives of the member countries and of the European Commission, which possesses the ultimate oversight and decision-making authority in the OECD. *Id.*

50. The conference was entitled *Dismantling the Barriers to Global Electronic Commerce*. OECD, *IMPLEMENTING OTTAWA TAXATION FRAMEWORK*, *supra* note 33, at 10.

51. COCKFIELD ET AL., *TAXING DIGITAL COMMERCE*, *supra* note 11, at 197 n.8.

52. OECD, *IMPLEMENTING OTTAWA TAXATION FRAMEWORK*, *supra* note 33, at 10.

53. *Id.* The report is set out in *id.* at 228–34.

where consumption takes place and an international consensus should be sought on the circumstances under which supplies are held to be consumed in a jurisdiction.

- For the purposes of consumption taxes, the supply of digitized products should not be treated as a supply of goods.
- Where business and other organizations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms where this would give immediate protection of their revenue base and of the competitiveness of domestic suppliers.<sup>54</sup>

Following the Ottawa Conference, the CFA, acting through its newly minted Working Party No. 9 on Consumption Taxation (WP 9),<sup>55</sup> and several technical advisory groups (TAGs),<sup>56</sup> undertook “an ambitious work programme . . . to maintain the momentum achieved at Ottawa . . . and implement globally the Taxation Framework Conditions.”<sup>57</sup> The first concrete guidelines to emerge from this work program were issued in 2001.<sup>58</sup> In addition to reiterating the basic principles set forth above, and emphasizing that their purpose was to prevent double taxation and unintentional non-taxation, the guidelines took the first step in putting some flesh on the bones of the rule that consumption should be taxed where consumption occurs in the context of cross-border trade in “intangible services,”<sup>59</sup> which the guidelines

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54. *Id.* at 231.

55. The Working Party had its first meeting in 1999. See DAFFE/CFA/WD(2000)2, <http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAFFE/CFA/WD%282000%292&docLanguage=En>.

56. OECD Committees, operating through their working parties (comprising OECD member country and “observer” country representatives) can involve non-member countries, academics, business representatives, and trade union representatives in their work as “experts.” This often leads to the creation of TAGS, whose role is purely advisory but whose members’ knowledge and experience assist the Committees in taking their work forward.

57. OECD, IMPLEMENTING OTTAWA TAXATION FRAMEWORK, *supra* note 33, at 12.

58. OECD, *E-Commerce Guidelines*, *supra* note 45, at 44–47.

59. See *supra* notes 44–46 and accompanying text.

now defined as “cross-border supplies of services and intangible property that are capable of delivery from a remote location.”<sup>60</sup>

Although the OECD made progress over the succeeding five years in its effort to develop guidance to implement the Ottawa Taxation Framework Conditions as applied to consumption taxation of electronic commerce, it had become increasingly apparent that the problems of consumption taxation of international trade in intangible services in the e-commerce context was just one facet of the broader problem of consumption taxation of international trade in services and intangibles generally. Accordingly in 2006, the CFA undertook the task of providing broad guidance through the development of international VAT/GST Guidelines. The initial version of the Guidelines was a skeletal document, consisting of little more than a general preface describing the growth of VAT and the OECD’s prior work in the area, a table of contents that was essentially an agenda for future work, and a statement of general principles reflected in the Ottawa Taxation Framework Conditions.<sup>61</sup> Indeed, in anticipation of the work that lay ahead, the CFA created a new Technical Advisory Group (TAG) on the international VAT/GST Guidelines.

Over the succeeding nine years, Working Party No. 9, the TAG, various dedicated “task teams,” and the OECD Secretariat worked to develop the Guidelines. Among other things, this work involved the elaboration of neutrality principles for VAT in the context of international trade; facilitating implementation of the destination principle in connection with B2B supplies, both for entities with single locations and with multiple locations; implementation of the destination principle in connection with B2C supplies, both for on-the-spot supplies and for other supplies; and specific rules both for B2B and B2C transactions when the general rules may not be appropriate; and practical guidance for encouraging consistent application of the Guidelines, including mutual cooperation, exchange of information, and taxpayer services. In developing the Guidelines, the OECD issued draft versions of various

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60. OECD, *E-Commerce Guidelines*, *supra* note 45, at 44. The guidelines explicitly excluded “tangible” services from their application, which the guidelines described as including “services which are not capable of direct delivery from a remote location” (e.g., hotel accommodation and vehicle rental); “circumstances where the place of consumption may be readily ascertained, as is the case where a service is performed in the physical presence of both the service provider and the customer” (e.g., hairdressing); and circumstances “when the place of consumption can more appropriately be determined by reference to a particular criterion” (e.g., services related to particular immovable property or goods). *Id.* at 45.

61. OECD, INTERNATIONAL VAT/GST GUIDELINES (2006), <http://www.oecd.org/ctp/consumption/36177871.pdf>.

portions of the Guidelines for public consultation, as well as other public consultation documents.<sup>62</sup>

In July 2015, the CFA approved a consolidated version of the OECD's VAT/GST Guidelines, which were released at the OECD's Global Forum on VAT in November 2015. It is anticipated that the Guidelines will be formally adopted by the OECD Council<sup>63</sup> during 2016. As noted at the outset,<sup>64</sup> the Guidelines comprise not only individual, numbered Guidelines, but also discussion of general VAT principles, explanations of individual Guidelines, and extensive commentary and other guidance. The overriding purpose of the Guidelines is to reflect and advance an international consensus on how VAT should be designed and implemented with the aim of reducing the risks of double taxation and unintended non-taxation created by inconsistencies in the application of VAT to cross-border trade in services and intangibles.

### III. VAT NEUTRALITY PRINCIPLES

Chapter 2 of the Guidelines is devoted to VAT neutrality principles, with a focus on cross-border trade.<sup>65</sup> The individual Guidelines themselves reflect generally accepted principles of tax neutrality in the VAT context and are unproblematic, at least from an academic perspective. This is not to suggest that they are unimportant or cannot give rise to controversy over their implementation. Indeed, in reading the Guidelines, one should always bear in mind that they are directed at governments whose existing VAT regimes may not reflect the existing academic consensus on VAT design.

With respect to “[b]asic neutrality principles,”<sup>66</sup> the Guidelines set forth three specific precepts. Guideline 2.1 provides that “[t]he burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.”<sup>67</sup> Beyond its recitation of the virtually axiomatic principle that the burden of a VAT should not rest on business,<sup>68</sup>

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62. See COCKFIELD ET AL., *TAXING DIGITAL COMMERCE*, *supra* note 11, at 222–31.

63. As noted above, *see supra* note 49, the OECD Council is the body that possesses the ultimate decision-making authority in the OECD.

64. *See supra* note 1 and accompanying text.

65. OECD, *VAT/GST GUIDELINES*, *supra* note 1, ch. 2. For the discussion of the core features of VATs, most of which I have considered above, see Chapter 1 of the Guidelines.

66. OECD, *VAT/GST GUIDELINES*, *supra* note 1, ch. 2(B), at 15 (i.e., principles related to the basic design features of a VAT without regard to international trade).

67. *Id.* Guideline 2.1, at 15.

68. *See supra* Part II(A).

Guideline 2.1 is significant in that it recognizes governments' right to deviate from this principle, at least when they do so by explicit legislation. This is simply an acknowledgment of the fact that governments sometimes deliberately impose VATs on businesses for legitimate—or, perhaps more accurately, plausible—reasons.

Many VATs, for example, provide exemptions for particular types of supplies or suppliers because the suppliers' outputs (such as financial transactions) are difficult to assess or because they are considered to be worthy of tax relief for social policy reasons (such as health care, education, and culture).<sup>69</sup> The consequence is to impose a burden on the business, which must pay a tax on its inputs but is not permitted to deduct the tax on its outputs, because they are exempt from tax.<sup>70</sup> Whether or not exemptions represent sound VAT policy,<sup>71</sup> and from a policy perspective they almost certainly do not,<sup>72</sup> the Guidelines' accommodation to governments' prerogative to deviate from the fundamental principle that "the burden of value added taxes themselves should not lie on taxable businesses" reflects an important aspect of the Guidelines, namely, that they constitute "soft law" and therefore must

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69. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 2.4, at 15–16.

70. *Id.* para. 2.4, at 15–16. In VAT parlance, "[a]n exemption occurs when output is untaxed but input tax is not recoverable." EBRILL ET AL., MODERN VAT, *supra* note 31, at 83. By contrast, when output is untaxed and input tax is recoverable, the transaction would be characterized as "zero-rated" or an "exemption with input tax credit." See generally Hellerstein & Duncan, *VAT Exemptions*, *supra* note 11, at 990 n.7. For the American mindset, this is a significant difference that needs to be understood fully. In the U.S. state sales tax system, we tend to think of exemptions from the purchaser's point of view because the exempt purchaser enjoys an economic benefit and there is no self-evident adverse impact on the seller. *But see* Walter Hellerstein, *Comparing the Treatment of Charities under Value Added Taxes and Retail Sales Taxes*, in RITA DE LA FERIA, ED., VAT EXEMPTIONS: CONSEQUENCES AND DESIGN ALTERNATIVES 175 (2013) [hereinafter Hellerstein, *Comparing the Treatment of Charities*]. In a VAT system, however, the supplier who is exempt on its sales—as distinguished from selling zero-rated supplies—is saddled with the burden of the VAT, at least as a legal matter. As an economic matter, of course, the extent to which the exempt seller can pass the burden of the VAT on to its purchasers (or pass it back to its suppliers) is a different question that turns on the cross-elasticities of supply and demand in the relevant market for the supplies in question.

71. There is considerable debate over this question in the VAT literature. See generally Hellerstein, *Comparing the Treatment of Charities*, *supra* note 70.

72. As the International Monetary Fund's leading text on VAT puts it, "[e]xemptions are abhorrent to both the logic and the functioning of the VAT." EBRILL ET AL., MODERN VAT, *supra* note 31, at 100; see also OECD, CONSUMPTION TAX TRENDS 2014, *supra* note 6, at 46–47 (characterizing exemptions as "a significant departure from the basic concept of VAT"); Hellerstein & Duncan, *VAT Exemptions*, *supra* note 11, at 991–95 (describing problems with VAT exemptions).

be sensitive to the political reality of the universe of “hard law” within which they operate, even when it may stray from the ideal theoretical norm.<sup>73</sup>

The other two “basic” VAT neutrality principles do not raise any theoretical eyebrows. Guideline 2.2 provides that “[b]usinesses in similar situations carrying out similar transactions should be subject to similar levels of taxation.”<sup>74</sup> Guideline 2.3 provides that “VAT rules should be framed in such a way that they are not the primary influence on business decisions.”<sup>75</sup> The devil here, of course, is in the details and the Guidelines provide useful Commentary (supported by examples) on what is meant by “similar levels of taxation,” “businesses in similar situations,” “similar transactions,” and “primary influence on business decisions.”<sup>76</sup>

Three specific Guidelines are addressed to VAT neutrality in international trade. Like the “basic” neutrality Guidelines, the neutrality Guidelines addressed to international trade articulate uncontroversial principles at a high level of generality. Guideline 2.4, which is addressed to the “level of taxation,” provides that “foreign businesses should not be disadvantaged or advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid.”<sup>77</sup> Guideline 2.5 recognizes that “jurisdictions may choose from a number of approaches” in order “[t]o ensure foreign businesses do not incur irrecoverable VAT.”<sup>78</sup> The premise of Guideline 2.5—that foreign businesses should not incur irrecoverable VAT—is obviously subject to the caveat that the jurisdiction has not imposed the burden of VAT on the business by explicit legislation, in accord with Guideline 2.1.<sup>79</sup> Nevertheless, assuming that domestic businesses are not saddled with irrecoverable VAT, Guideline 2.5 also makes it clear that there are a variety of approaches for achieving this objective with respect to foreign businesses, even though these may not be the same approaches employed for achieving the objective with respect to domestic businesses. The Commentary elaborates on this point, observing that the approaches for relieving foreign businesses of irrecoverable VAT may include a system for application for direct refunds of local VAT; refunds through local VAT registration; shifting

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73. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 2.1, at 15, para. 4.9, at 76. The Commentary on Guideline 2.1 makes this point explicit, observing that “Guideline 2.1 is not intended to interfere with the sovereignty of jurisdictions to apply rules for limiting or blocking the right to deduct input VAT.” *Id.* para. 2.35, at 21.

74. *Id.* Guideline 2.2, at 16.

75. *Id.* Guideline 2.3, at 16.

76. *Id.* paras. 2.39–2.52, at 21–24.

77. *Id.* Guideline 2.4, at 16.

78. *Id.* Guideline 2.5, at 17.

79. *See supra* notes 67–73 and accompanying text; *see also*, OECD, VAT/GST GUIDELINES, *supra* note 1, para. 2.18, at 17–18.

the responsibility to locally registered suppliers or customers (“reverse charge”); and granting purchase exemption certificates.<sup>80</sup> Finally, Guideline 2.6, while acknowledging that foreign businesses may legitimately be subject to different administrative requirements than those applied to domestic businesses, declares that in such cases these requirements “should not create a disproportionate or inappropriate compliance burden for the businesses.”<sup>81</sup>

#### IV. BUSINESS-TO-BUSINESS (B2B) TRANSACTIONS

##### A. *The Destination Principle*

As we have already observed,<sup>82</sup> the OECD’s International VAT/GST Guidelines embrace the destination principle as the basic rule for application of the VAT to cross-border trade in accord with the widespread international consensus. Accordingly, Guideline 3.1 provides: “For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption.”<sup>83</sup> Practical implementation of the destination principle<sup>84</sup> in the B2C context through adoption of place-of-taxation rules that identify the destination of a B2C sale makes good theoretical sense on the reasonable assumption that the destination of a B2C sale, however identified, is generally a good proxy for determining where final consumption is likely to take place,<sup>85</sup> and “[r]ules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.”<sup>86</sup>

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80. OECD, VAT/GST GUIDELINES, *supra* note 1, paras. 1.15, at 13, 2.16, at 17.

81. *Id.* Guideline 2.6, at 18.

82. *See supra* Part II(B)(1).

83. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 3.1, at 27. The careful reader will notice a slight variation from the original wording of this principle in the Ottawa Taxation Framework Conditions, to wit, that “[r]ules for the consumption taxation of cross-border trade *should result in taxation* in the jurisdiction where consumption takes place.” OECD, IMPLEMENTING OTTAWA TAXATION FRAMEWORK, *supra* note 33, at 231 (quoted *supra* note 54 and accompanying text) (emphasis added). The change implicitly addresses the situation in the United States, the only OECD Member State without a VAT. According to U.S. national rules, consumption *should not* “result in taxation” in the jurisdiction where consumption takes place, because the United States has no national broad-based consumption tax.

84. Under the destination principle, final consumption is taxed in the jurisdiction where it actually occurs. *See infra* text accompanying note 86.

85. *See infra* Part V.

86. OECD, IMPLEMENTING OTTAWA TAXATION FRAMEWORK, *supra* note 33, at 5.

B2B transactions, however, generally involve business use as distinguished from final consumption.<sup>87</sup> Consequently, under the normal assumption that “business-to-business supplies . . . do not involve final consumption,”<sup>88</sup> implementation of the destination principle as a means for identifying (or approximating) the jurisdiction of final consumption would appear to lose its theoretical relevance as a basis for identifying the jurisdiction in which B2B supplies should be taxed under a VAT. Indeed, as we have observed above,<sup>89</sup> “the destination principle . . . is therefore entirely silent on which jurisdiction should tax business-to-business (B2B) transactions.”<sup>90</sup>

The destination principle, even though it applies in theory only to B2C transactions, nevertheless plays an important role in the OECD's VAT/GST Guidelines in connection with B2B transactions, and it is important to understand why this is so. Perhaps the first point to make—and it is one we have made at several points in the preceding discussion, but is important enough to repeat<sup>91</sup>—is that the destination principle, from the perspective of tax administration, “seeks to approximate the location of consumption in a sensible and administrable fashion, not . . . to identify the location where consumption actually occurs.”<sup>92</sup> Once one views the destination principle as a pragmatic mechanism for identifying the appropriate place of taxation rather than a means of satisfying a theoretical norm for determining where consumption actually occurs—a point we will revisit in the B2C context—it becomes easier to understand why identifying the “destination” of a supply in the B2B context may function satisfactorily as a place-of-taxation rule, even if it does not reflect the destination principle viewed narrowly as the place where final consumption actually occurs. If identifying the “destination” of a supply in the B2B context identifies a jurisdiction where tax can effectively be collected—i.e., if it is “good enough for government work, which . . . is what taxation is all about”<sup>93</sup>—do we really need to answer the academics' question: It works in practice, but does it work in theory?

Moreover, even if we do, there is in fact a theoretically defensible rationale for employing a destination-based approach for identifying the

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87. The reason for the qualification of the sentence is that businesses sometimes acquire supplies for the personal use of their owners, in which case the B2B supply in substance is, in whole or in part, a B2C supply and would be treated as such under most VAT regimes. EBRILL ET AL., *MODERN VAT*, *supra* note 31, at 18.

88. OECD, *VAT/GST GUIDELINES*, *supra* note 1.

89. Albeit in a characteristically forgettable footnote. *See supra* note 34.

90. Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 366–67.

91. This point is relevant to B2C transactions as well as to B2B transactions.

92. Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 367.

93. *Id.*

appropriate place of taxation in the B2B context that is influenced by the destination principle for identifying the place of final consumption (and taxation in the B2C context). As the Guidelines declare: “In theory, place of taxation rules should aim to identify the actual place of business use for business-to-business supplies (on the assumption that this best facilitates implementation of the destination principle) and the actual place of final consumption for business-to-consumer supplies.”<sup>94</sup> The use of a destination-based approach for place-of-taxation rules in the B2B context can therefore be justified theoretically as means for “[i]mplementing the destination principle.”<sup>95</sup>

Although the destination-based approach to place-of-taxation rules in both the B2B and B2C contexts focuses on the location (or deemed location) of the purchaser (whether a business or a consumer), the important differences between the two contexts identified above inform the objectives and design of the destination-based approaches in the two contexts. The Guidelines explicitly recognize this difference, and we quote the Guidelines’ explanation at some length because of its significance to their approach to the B2B and B2C place-of-taxation rules:

[T]axation of business-to-consumer supplies involves the imposition of a final tax burden, while taxation of business-to-business supplies is merely a means of achieving the ultimate objective of the tax, which is to tax final consumption. Thus, *the objective of place of taxation rules for business-to-business supplies is primarily to facilitate the imposition of a tax burden on the final consumer in the appropriate country while maintaining neutrality within the VAT system. The place of taxation rules for business-to-business supplies should therefore focus not only on where the business customer will use its purchases to create the goods, services[,] or intangibles that final consumers will acquire, but also on facilitating the flow-through of the tax burden to the final consumer while maintaining neutrality within the VAT system.*<sup>96</sup>

By contrast, as the Guidelines also recognize, “[t]he overriding objective of place of taxation rules for business-to-consumer supplies . . . is to predict, subject to practical constraints, the place where the final consumer is

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94. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.6, at 28–29.

95. *Id.* para. 3.9, at 29 (i.e., the destination-based approach for place-of-taxation rules in the B2C context).

96. *Id.* para. 3.5, at 28 (emphasis added).

likely to consume the services or intangibles supplied.”<sup>97</sup> In addition, because of the different characteristics of supplies to businesses and supplies to households, VAT systems often employ different mechanisms to collect the tax in connection with B2B and B2C supplies, and these different mechanisms in turn “often influence the design of place of taxation rules and of the compliance obligations for suppliers and customers involved in cross-border supplies.”<sup>98</sup>

Finally, and again at the risk of repeating what has already been said but balancing that risk against the importance of the point, particularly for “hitchhikers” who may be unfamiliar with the territory, whatever may be the theoretical case for B2B taxation place-of-taxation rules that “identify the actual place of business use for business-to-business supplies,”<sup>99</sup> “the Guidelines recogni[z]e that place of taxation rules are in practice rarely aimed at identifying where business use . . . actually takes place.”<sup>100</sup> Because the place of actual business use is generally not known at the time of the supply, “VAT systems . . . generally use proxies for the place of business use . . . to determine the jurisdiction of taxation, based on features of the supply that are known or knowable at the time that the tax treatment of the supply must be determined.”<sup>101</sup> In short, the place-of-taxation rules “for border-crossing B2B transactions ultimately must be pragmatic.”<sup>102</sup> What is needed, and what the Guidelines seek to provide, are “sensible and practicable rule[s] that facilitate the implementation of the destination principle—the taxation of final consumption by real people.”<sup>103</sup>

#### B. *B2B Supplies—The General Rule*

To facilitate implementation of the destination principle reflected in Guideline 3.1,<sup>104</sup> Guideline 3.2 provides the following general<sup>105</sup> place-of-taxation rule: “[F]or business-to-business supplies, the jurisdiction in which the customer is located has the taxing rights over internationally traded

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97. *Id.*

98. *Id.*

99. *Id.* para. 3.6, at 28.

100. *Id.*

101. *Id.*

102. Keen & Hellerstein, *Interjurisdictional Issues*, *supra* note 11, at 367.

103. *Id.*

104. *See supra* note 83 and accompanying text.

105. The general place-of-taxation rules (in both the B2B and B2C contexts) are to be distinguished from the specific place-of-taxation rules for particular types of supplies discussed *infra* Part VI.

services or intangibles.”<sup>106</sup> On the assumption that implementation of the destination principle can best be facilitated by taxing cross-border B2B supplies at the location of business use,<sup>107</sup> the rule is justified by the fact that “the jurisdiction of the customer’s location can stand as the appropriate proxy for the jurisdiction of business use.”<sup>108</sup> The question then becomes “How does one determine the jurisdiction in which the customer is located?”

The answer to the question depends on the answer to two subsidiary questions: “Who is the customer?” and “Where is the customer located?” The answer to the first question, according to the Guidelines, “is normally determined by reference to the business agreement.”<sup>109</sup> A “business agreement” is not a formal legal concept, but simply embodies the elements that permit one to “identify the parties to a supply and the obligations with respect to that supply.”<sup>110</sup> Once the customer is determined, the customer’s location is also determined for an entity with a single location (a “single location entity” or “SLE”). If a customer has more than one location—a legal entity that has establishments in more than one jurisdiction” (a “multiple location entity” or “MLE”)<sup>111</sup>—the inquiry into which of the jurisdictions in which the MLE has establishments is the “customer location” with taxing rights over the service or intangible acquired by the MLE becomes more complicated.

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106. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 3.2, at 29.

107. *See id.* paras. 3.5, at 28, 3.9, at 29; *see also supra* text accompanying note 45.

108. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.9, at 29.

109. *Id.* Guideline 3.3, at 27–28.

110. *Id.* Box 3.1, at 30.

111. *Id.* para. 3.22 n.24, at 31 (footnote omitted in text) (“For the purpose of the Guidelines, it is assumed that an establishment comprises a fixed place of business with a sufficient level of infrastructure in terms of people, systems and assets to be able to receive and/or make supplies.”). For American (and perhaps other) readers, who may be more familiar with “permanent establishments” for income tax purposes, *see* OECD, MODEL TAX CONVENTION ON INCOME AND CAPITAL art. 5 (2014) [hereinafter OECD, MODEL INCOME AND CAPITAL], than with “fixed” or other establishments for VAT purposes, *see* Hellerstein, *Permanent and Other Establishments*, *supra* note 11; Rasa J. Mikutienė, *The Preferred Treatment of the Fixed Establishment in the European VAT*, 3 WORLD J. VAT/GST L. 166, 168 (2014), one should not assume that the word “establishment” has the same meaning in both contexts. Indeed, one might characterize the respective “establishments” as *faux amis* (false friends), namely, words—as English-speaking students of French are routinely warned—that have different meanings in different languages even though they are spelled the same way (e.g., pain (which means bread in French, and, normally, something else in English)).

### 1. *Single Location Entities ("SLEs")*

As we have just noted, implementation of the B2B place-of-taxation rule based on customer location with regard to SLEs is straightforward, at least in principle. This is because of the truism that a single location entity can have a customer location in only one jurisdiction, so the determination of the customer determines the customer's location and the place of taxation. To be sure, there can be uncertainty as to whether a customer is a SLE or a MLE, because the resolution of that question depends on whether the customer has an "establishment" in more than one jurisdiction; the resolution of that question, in turn, depends on whether the customer has "a fixed place of business with a sufficient level of infrastructure in terms of people, systems and assets to be able to receive and/or make supplies";<sup>112</sup> and the resolution of that question may not be self-evident in all cases, particularly when it depends on the law of different countries that may provide different answers to the question based on the same set of facts. However, these are the types of questions that are endemic to any system of law, particularly in a global context, and one cannot expect (or reasonably demand) that a set of international "soft law" guidelines address them explicitly.<sup>113</sup>

Once it is determined that the customer of a B2B supply is a SLE, thereby establishing the place of taxation at the customer's single location, the Guidelines' Commentary, in accord with the earlier suggestion in the Ottawa Taxation Framework Conditions,<sup>114</sup> recommends that the VAT be implemented through the use of the "reverse charge" (or "self-assessment") mechanism when this is consistent with the design of the national consumption tax system.<sup>115</sup> Under the reverse charge mechanism, the customer accounts for

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112. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.22, n.24, at 31.

113. In this connection, however, it is worth noting that Chapter 4 of the Guidelines (Supporting the Guidelines in Practice) strongly encourages tax administrations "to utili[z]e existing mechanisms for mutual co-operation, information exchange, and mutual assistance . . . to facilitate a consistent interpretation under national law or practice of the Guidelines . . . , to facilitate the minimi[z]ation of disputes arising within the scope of such Guidelines." *Id.* para. 4.10, at 76. *See infra* Part VII. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 4.11, at 76. Moreover, in what may be read as an implicit blueprint for future work in this area, the Guidelines "further encourage" jurisdictions "to explore a variety of approaches beyond the existing mechanisms . . . to effect a consistent interpretation of the Guidelines on neutrality and on place of taxation," including "the development of additional guidance, under the auspices of the OECD's Committee on Fiscal Affairs (CFA) and its subsidiary bodies, in the form of 'best practices' or recommended approaches for implementing the Guidelines as a means of assuring their consistent interpretation."

114. *See supra* note 54 and accompanying text.

115. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.47, at 35.

any tax due in its jurisdiction. In the cross-border context, such an approach ordinarily has the distinct advantage of relieving the supplier of any obligation to be identified for VAT purposes or to account for tax in the customer's jurisdiction.<sup>116</sup>

As the Guidelines elaborate:

The reverse charge mechanism has a number of advantages. First, the tax authority in the jurisdiction of business use can verify and ensure compliance since that authority has personal jurisdiction over the customer. Second, 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. Third, the administrative costs for the tax authority are also lower because the supplier is not required to comply with tax obligations in the customer's jurisdiction (*e.g.* VAT identification, audits, which would otherwise have to be administered, and translation and language barriers). 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.<sup>117</sup>

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116. *Id.* In the U.S. subnational context, this approach is analogous to the use of a "direct pay" permit under which some business taxpayers, especially larger purchasers, register with states and agree to "self-assess" a use tax on all taxable goods and services they purchase. *See* HELLERSTEIN, STATE TAXATION TREATISE, *supra* note 7, ¶ 16.01. The Federation of Tax Administrators describes the direct payment process as follows:

Direct pay is authority granted by a tax jurisdiction that generally allows the holder of a direct payment permit to purchase otherwise taxable goods and services without payment of tax to the supplier at the time of purchase. (Also in the case of exempt transactions, it allows a holder to purchase without issuing exemption certificates.) Suppliers are to be furnished a written notification of the purchaser's direct pay authority (often a numeric designation). The holder of the direct payment permit is to timely review its purchases and make a determination of taxability and then report and pay the applicable tax due directly to the tax jurisdiction. The permit holder's tax determination and adequacy of payment are subject to audit by the tax jurisdiction.

MODEL DIRECT PAYMENT PERMIT REGULATION: A REPORT OF THE STEERING COMMITTEE 2 (2000), <http://www.taxadmin.org/assets/docs/publications/dpay.pdf>.

117. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.64, at 38.

The Guidelines' Commentary on the place of taxation for B2B supplies to SLEs also makes it clear that the general rule as articulated above is not affected by what might be characterized as collateral aspects of the supply. Thus, the determination of the place of taxation is not affected by the fact that the customer under the business agreement may "resupply" those same services or intangibles to a related party.<sup>118</sup> Such "resupplies" (or "onward supplies," to use the terminology of the Guidelines)<sup>119</sup> will presumably be made pursuant to other business agreements and the appropriate place of taxation for those supplies will be determined under those agreements. Similarly, the place of taxation is not affected by the fact that the services or intangibles supplied are actually provided directly to a third party other than the customer (e.g., if a parent company purchases services but instructs the supplier to perform them for a subsidiary in another jurisdiction).<sup>120</sup> Again, the place of taxation with respect to the supply will be determined by the business agreement between the supplier and the customer (the parent), and there will be a separate supply (and business agreement) between the parent and the subsidiary in which the parent is the supplier and the subsidiary is the customer.<sup>121</sup> In the same vein, the determination of the place of taxation is not affected by the direction of the payment flows or the identity and location of the payor.<sup>122</sup>

## 2. *Multiple Location Entities ("MLEs")*

When a supply is made to a MLE,<sup>123</sup> the place of taxation cannot be determined simply by looking to the customer identified in the business

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118. *Id.* paras. 3.50–3.52, at 35–36, 3.58, at 37, 3.66, at 39.

119. *Id.*

120. *Id.* paras. 3.53, at 36, 3.59, at 37, 3.67, at 39, ch. 3 annex I (ex. 3), at 64–66.

121. *Id.*

122. *Id.* paras. 3.52, at 36, 3.54, at 36, 3.60, at 37–38, 3.68, at 39, ch. 3 annex 1 (ex. 5), at 69–70. As the cited paragraphs of the Guidelines' Commentary explain, although the customer will typically pay the supplier for services or intangibles supplied under a business agreement, there are circumstances in which another party may pay for that supply. It is typical, for example, for multinational groups of businesses to appoint a group member to act as common "paymaster" for services and intangibles acquired by group members. In such cases, the customer might not be the party who pays the supplier for the supply under the business agreement. Nevertheless, the direction of the payment flows and the identity and location of the "paymaster" do not determine the identity of the customer (and, hence, the place of taxation), which depend on the relevant business agreement.

123. *See supra* note 111 and accompanying text. It is important to keep in mind that a MLE is a *single legal entity*, albeit one with multiple locations or branches,

agreement, as in the case of SLEs.<sup>124</sup> Instead, an additional inquiry must be undertaken to determine the jurisdiction (or jurisdictions) in which the MLE's establishment (or establishments) use the service or intangible.<sup>125</sup> These are the jurisdictions that should have taxing rights over the supply on the theory that the destination principle can best be implemented by taxing cross-border B2B supplies at the location of business use.<sup>126</sup>

The Guidelines recognize that there is not a one-size-fits-all approach to determining which of a MLE's establishments uses a service or intangible and where such establishment is located and that countries take different approaches to this question.<sup>127</sup> Specifically, the Guidelines identify three approaches to determining the establishment of a MLE that is regarded as using a service or intangible and where the establishment is located:

- Direct use approach, which focuses directly on the establishment that uses the service or intangible[;]
- Direct delivery approach, which focuses on the establishment to which the service or intangible is delivered[;] and
- Recharge method, which focuses on the establishment that uses the service or intangible as determined on the basis of internal recharge arrangements within the MLE, made in accordance

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and the Guidelines' suggested place-of-taxation rules for MLEs are addressed only to what might be characterized as intra-entity or branch-to-branch supplies. *See infra* note 132 and accompanying text. When supplies are purchased by one *legal entity* for the benefit of a related *legal entity or entities* (e.g., when a centralized purchasing company acquires auditing services for a multinational enterprise with subsidiaries around the world), the place-of-taxation rule for each supply to each legal entity is determined in accordance with the business agreement applicable to the supply to such legal entity. *See supra* Part IV(B)(1); OECD, VAT/GST GUIDELINES, *supra* note 1, ch. 3 annex 1, at 62–70 (providing examples of B2B place-of-taxation rules for supplies provided to groups of related companies based on separate business agreements applicable to each separate supply). In this connection, it is worth noting that the Guidelines are drafted on the assumption that the “parties involved act in good faith and all transactions are legitimate and with economic substance.” *Id.* para. 4.22, at 78.

124. *See supra* Part IV(b)(1).

125. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 3.4, at 32 (providing that, for purposes of determining the customer location of a MLE, “the taxing rights accrue to the jurisdiction(s) where the establishment(s) using the service or intangible is (are) located”).

126. *Id.* para. 3.6, at 37–38; *see also id.* para. 3.23, at 31.

127. *Id.* para. 3.25, at 32.

with corporate tax, accounting or other regulatory requirements.<sup>128</sup>

The Guidelines further recognize that each of the approaches may be appropriate for particular circumstances and that whatever approach is adopted should reflect a sound balance between the interests of business (both suppliers and customers) and tax administrations.<sup>129</sup>

*a. The “Direct Use” and “Direct Delivery” Approaches*

The “direct use” and “direct delivery” approaches are essentially self-explanatory and, in many cases, will overlap, (i.e., the customer’s establishment that uses the service or intangible will also be the customer’s establishment to which the service or intangible is delivered). In some instances, however, this will not be true, for example, in the case in which the supplier knows that the customer will be using the supply at an establishment other than the one to which it is delivered. This might be the case, for example, if software were delivered electronically to an establishment of the customer that was not the customer’s establishment where the supplier knew that the software would be used. The “direct delivery” approach is particularly appropriate for “on-the-spot” supplies—supplies that are ordinarily used at the same time and at the same place where they are physically provided<sup>130</sup>—such as catering or on-the-spot training.<sup>131</sup>

*b. The “Recharge” Method*

The “recharge” method is the most innovative and, at least from the perspective of existing VAT law, most controversial<sup>132</sup> of the approaches to

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128. *Id.*

129. *Id.* para. 3.28, at 32.

130. In the B2C context, there is a separate Guideline for such supplies. *Id.* Guideline 3.5; see discussion *infra* Part IV(C)(2).

131. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.31, at 33.

132. While income tax regimes have long been comfortable with the notion that one can determine tax liabilities on the basis of hypothesized or “fictional” transactions between establishments or branches of a single legal entity, see, e.g., I.R.C. § 884 (imposing “branch profits tax” on dividends deemed to have been paid by domestic branches of foreign corporations, based on a determination whether U.S. earnings and profits have effectively been expatriated); OECD, MODEL INCOME AND CAPITAL, *supra* note 111, art. 7 (attributing business profits to permanent establishments of a single legal entity based on “profits it might be expected to make . . . if it were a separate and independent enterprise”), the determination of tax liabilities based on the hypothesized existence of branch-to-branch transactions under

determining the establishment of a MLE that is regarded as using a service or intangible. Under the recharge method, MLEs are required to recharge the cost of an externally acquired service or intangible to their establishments that use this service or intangible, as supported by internal recharge arrangements.<sup>133</sup> The internal recharges are then used as a basis for allocating the taxing rights over the external service or intangible to the jurisdiction where the MLE's establishment using this service or intangible is located. The Guidelines observe that this approach may be particularly useful in cases where a service or intangible supplied by an external supplier to a MLE is acquired by one establishment of the MLE for use wholly or partially by other establishments located in different jurisdictions (multiple use), including administrative, technical, financial, and commercial services,<sup>134</sup> because of the difficulty of determining which of the MLE's establishments will actually use the services or intangibles. The recharge method could offer an effective means of identifying the place of taxation in these multiple use scenarios, which are an increasingly common characteristic of the digital economy.

In further elaborating on the recharge method, the Guidelines' Commentary notes, among other things, that:

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VAT has traditionally been a more controversial issue. Alain Charlet & Dimitra Koulouri, *Relations Between Head Offices and Permanent Establishments: VAT/GST v. Direct Taxation: The Two Faces of Janus*, in *VALUE ADDED TAX AND DIRECT TAXATION: SIMILARITIES AND DIFFERENCES* 703 (Michael Lang et al., eds., 2009) [hereinafter Charlet & Koulouri, *Relations Between Head Offices and PEs*]. To be sure, some intra-entity "transactions," such as self-supplies when a business entity converts assets to personal use, are typically subject to VAT, as are imported goods when supplied by another branch of the same legal entity. *Id.* at 713. *See, e.g.*, EU VAT Directive, *supra* note 4, arts. 74, 75. When it comes to cross-border supplies of services and intangibles, however, the question of whether VAT should recognize branch-to-branch transactions as constituting taxable events has been more controversial. For example, in the *FCE Bank* case, the European Court of Justice held that for purposes of the EU VAT the branch of a financial institution could not be considered a separate "taxable person" with its own VAT liability independent of the company of which it formed part. Case C-210/04, *Ministero dell'Economia e delle Finanze, Agenzia delle Entrate v. FCE Bank plc*, 2006 E.C.R. I-2825. However, it arguably remains an open question whether a branch could *ever* be a "taxable person" under the EU VAT. Charlet & Koulouri, *Relations Between Head Offices and PEs*, *supra* note 132, at 716–17. On the other hand, many non-EU countries, including Australia, Canada, New Zealand, South Africa, and Switzerland, routinely treat cross-border inter-branch transactions as supplies for VAT purposes. *Id.* at 715.

133. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.32, at 33.

134. *Id.* para. 3.33, at 33.

- The internal charge of the external service or intangible is treated as consideration for a supply within the scope of VAT.<sup>135</sup>
- Under the recharge method, MLEs will need to have internal arrangements in place to support and facilitate the internal charges between their different establishments.<sup>136</sup>
- While the application of the recharge method may be straightforward in many cases, in other cases it will be more difficult, such as those in which services or intangibles are acquired for use by multiple establishments and a separate recording of use by each of the establishments would be disproportionately burdensome. In such cases, MLEs may find it necessary to use cost allocation or apportionment methods that include a certain degree of estimation or approximation of the actual use of the service by each establishment and thus the appropriate recharge associated with the use.<sup>137</sup>
- The cost allocation or apportionment methods should be “fair and reasonable,” in that they should produce recharges that are commensurate with the reasonably expected use by the establishments of use, follow sound accounting principles, and contain safeguards against manipulation. Where possible, information that is already available for accounting and tax and other regulatory purposes should be used.<sup>138</sup>
- The objective of the recharge method is to ensure that taxing rights over supplies to a MLE are effectively allocated to the jurisdiction where the establishment of use is located. The MLE will therefore be expected to ensure that tax administrations can reasonably establish the relationship between the initial supply and the recharge and that they can notably establish the link between the price of the initial supply and the amount of the recharge, without requiring a recharge on a transaction-by-transaction basis.<sup>139</sup>

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135. *Id.* para. 3.84, at 42.

136. *Id.* para. 3.88, at 42 (the “recharge arrangement”).

137. *Id.* paras. 3.90–3.91, at 42–43.

138. *Id.* para. 3.93, at 43.

139. *Id.* para. 3.95, at 43.

- The taxable amount for VAT purposes under the recharge method would in principle be the part of the purchase price for the service or intangible from the external supplier to the MLE that is recharged to the customer's establishment based on the establishment's use (or deemed use) of the service under an acceptable apportionment or allocation approach.<sup>140</sup>
- On the basis of the taxable amount evidenced by the recharge arrangement, the customer's establishment would then be entitled to deduct input tax to the extent allowed under the rules of its jurisdiction.<sup>141</sup>

The Guidelines are noticeably silent on the relevance, if any, to the recharge method of the OECD's income tax guidance, based on the arm's-length principle, for attributing profits to permanent establishments.<sup>142</sup>

## V. BUSINESS-TO-CONSUMER (B2C) TRANSACTIONS

### A. *The Destination Principle*

The destination principle has a more powerful theoretical link to the destination-based place-of-taxation rules for B2C transactions than it does for

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140. *Id.* paras. 3.99–3.100, at 44.

141. *Id.* para. 3.101, at 44. Where the recharge of a service or intangible purchased from an external supplier is bundled with an internal cost charge (e.g., salary expense of internally supplied services), the MLE must separate the cost of the externally purchased service or intangible from the other costs and document the internal character of these other costs if necessary to ensure that the recharge method is applied only to the cost of the externally purchased service or intangible. *Id.* para. 3.102, at 44.

142. OECD, CTR. FOR TAX POLICY & ADMINISTRATION 2010, REPORT ON ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS (2010). For a consideration of this issue, see Hellerstein, *Exploring the Potential Linkages*, *supra* note 11, at 104–10. The OECD's Transfer Pricing Guidelines, OECD, TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS (2010), which concern the proper attribution of income *among commonly controlled separate legal entities*, have even a more uncertain relationship, if any, to the OECD's recharge method for MLEs, which, as noted above, is concerned only with the allocation of taxing rights *within a single legal entity*. See *supra* note 123 and accompanying text. As to the relevance of the Transfer Pricing Guidelines to the attribution of the tax base between commonly controlled entities for VAT purposes, see Hellerstein, *Exploring the Potential Linkages*, *supra* note 11, at 102–04.

the destination-based place-of-taxation rules for B2B transactions. This is so for the simple reason that the destination of a B2C sale is generally a reasonably good proxy for determining where actual final consumption is likely to take place whereas the destination of a B2B sale has a more attenuated connection to final consumption.<sup>143</sup> In other words, as we have already observed, the B2C place-of-taxation rules are designed to *implement* the destination principle whereas the B2B place-of-taxation rules are designed to *facilitate implementation of* the destination principle.

Although destination-based place-of-taxation rules may have a stronger theoretical justification in the B2C context than in the B2B context because of their stronger connection to predicted final consumption, what they gain in theory they may lose in practice, at least in an economy in which an increasing amount of cross-border B2C trade in services and intangibles is delivered by remote suppliers in digital form.<sup>144</sup> In the B2B context, VAT regimes generally can deal with the enforcement challenges associated with remote suppliers by shifting the tax collection responsibility from the supplier to the business customer, over whom they have unquestioned legal authority, under the reverse charge and similar mechanisms.<sup>145</sup> But these enforcement challenges lie at the heart of the issues associated with the implementation of the destination principle as applied to cross-border trade in services and intangibles in the B2C context. To be sure, there may be legal authority to require private consumers to remit the tax on the supplies that they consume (or are deemed to consume) at destination.<sup>146</sup> Nevertheless, in the absence of the political will to impose meaningful sanctions on private consumers who fail to remit the VAT on the supplies they purchase from remote suppliers, any requirement imposed directly on private consumers to remit tax on remote sales of services and intangibles amounts to little more than a “tax on honesty.”<sup>147</sup> It is for this reason that a substantial portion of the Guidelines addressed to remote B2C supplies focuses on guidance for jurisdictions to facilitate collection of tax by remote suppliers, because, as a practical matter,

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143. *See supra* Parts II(A), Part IV(A).

144. *See supra* Part II(B)(2)(b).

145. *See supra* notes 34–35 and accompanying text.

146. As we have already observed, *see supra* note 16 and accompanying text, some VAT regimes impose a legal obligation upon individual consumers to pay and remit the tax in some circumstances, *see* COCKFIELD, ET AL, *TAXING DIGITAL COMMERCE*, *supra* note 11, at 396–97, although other regimes confine VAT collection and remittance obligations to businesses.

147. Hellerstein, *Jurisdiction to Tax in the New Economy*, *supra* note 32, at 23 n.80 (citing Martha Kessler, *State's Tax Authorities Introduce Voluntary Use Tax Tracking Program*, DAILY TAX REP. (BNA), Jan 8, 2003, at H-3).

unless such suppliers collect the tax, little tax on remote supplies is likely to be collected.

*B. B2C Supplies—The General Rules*

There are two general place-of-taxation rules for implementing the destination principle in the B2C context.<sup>148</sup> The first of the two rules—the rule for “on the spot” supplies—is a reminder that some supplies are still consumed in the same jurisdiction in which they are provided notwithstanding the growth of the global digital economy. The second general rule—the residual rule that attributes all other B2C supplies to the customer’s usual residence—is a reminder that the place-of-taxation rules generally are *proxies* reflecting our “best guess” or reasonable approximation as to where consumption is likely to occur.

*1. B2C Supplies—The First General Rule (On-the-Spot Supplies)*

The first general rule for B2C supplies is the closest the Guidelines get to proposing a place-of-taxation rule that embodies the destination principle itself—*taxing actual consumption where consumption occurs*—rather than a proxy for predicting where consumption is likely to occur. Guideline 3.5 provides:

[T]he jurisdiction in which the supply is physically performed has the taxing rights over business-to-consumer supplies of services and intangibles that:

- are physically performed at a readily identifiable place, and
- are ordinarily consumed at the same time as and at the same place where they are physically performed, and
- ordinarily require the physical presence of the person performing the supply and the person consuming the service or intangible at the same time and place where the supply of such a service or intangible is physically performed.<sup>149</sup>

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148. As distinguished from the single general place-of-taxation general rule in the B2B context, *see supra* Part IV(B), and as further distinguished from the specific place-of-taxation rules in both the B2B and B2C contexts. *See infra* Part VI.

149. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 3.5, at 47.

In many respects, Guideline 3.5 is an “old economy” place-of-taxation rule. Indeed, it will be recalled that many jurisdictions once employed the rule that services should be taxed where the service provider is established, an origin-based place-of-taxation rule that nevertheless functioned satisfactorily as a destination-based place-of-taxation rule because many (if not most) services were consumed or used by the customers at the supplier’s location where they were provided.<sup>150</sup> Some services, of course, particularly in the B2C context, still fall squarely within that description. Despite the ability of twenty-first century doctors in New York to perform “telesurgery” on the gallbladder of a patient lying on an operating table in Strasbourg, France,<sup>151</sup> the fact remains that today many B2C services are consumed where they are performed just as they have been long before any one had ever heard of a VAT. Among those identified by the Guidelines are “services physically performed on the person (e.g. hairdressing, massage, beauty therapy, physiotherapy); accommodation; restaurant and catering services; entry to cinema, theatre performances, trade fairs, museums, exhibitions, and parks; attendance at sports competitions.”<sup>152</sup>

Although the scope of the “on-the-spot” supply rule is narrow, it is virtually a “perfect” place-of-taxation rule in terms of the criteria for evaluating the merits of such a rule. First, it identifies as reasonably as one can the place where the supply is “ordinarily consumed.” Second, it identifies a place that is easy for a supplier to determine and where it easily can comply with tax collection obligations. Third, it identifies a place over which the tax administration can easily exercise its authority to enforce compliance with the relevant tax obligations. Indeed, the rule is so good that the Guidelines recommend its use in the B2B context,<sup>153</sup> because on-the-spot supplies may be acquired by businesses as well as private consumers, but under the rubric of a “specific rule” in the B2B context.<sup>154</sup>

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150. *See supra* notes 40–41 and accompanying text.

151. D.L. Parsell, *Surgeons in U.S. Perform Operation in France via Robot*, NAT’L GEOGRAPHIC NEWS, Sept. 19, 2001, [http://news.nationalgeographic.com/news/2001/09/0919\\_robotsurgery.html](http://news.nationalgeographic.com/news/2001/09/0919_robotsurgery.html). According to the report, “[t]hrough a high-quality telecommunications circuit, the doctors in New York guided the movements of a three-armed robot in Strasbourg—about 6,230 kilometers (3,870 miles) away—that removed the gallbladder of a 68-year-old woman.” *Id.*

152. OECD, VAT/GST GUIDELINES, *supra* note 1, para 3.117, at 47.

153. OECD, VAT/GST GUIDELINES, *supra* note 1, para 3.119, at 48. In the B2B context, of course, the rule loses the virtue of identifying the place of actual consumption, although it does effectively identify the place of actual business use.

154. *Id.*; *see infra* Part VI for a discussion of specific rules. The Guidelines further note that adoption of such rule in the B2B context “would relieve suppliers of on-the-spot supplies . . . of the compliance burden of having to distinguish between final consumers and businesses when making their taxing decisions,” assuming that

2. *B2C Supplies—The Second General Rule (Supplies Other than On-the-Spot Supplies)*
  - a. *The “Usual Residence” Rule*

In contrast to on-the-spot supplies, for which the happy confluence of the existence of actual consumption at a readily identifiable location where taxing obligations can effectively be enforced determines the appropriate place-of-taxation rule,<sup>155</sup> most supplies do not lend themselves to such a finely calibrated place-of-taxation rule. Accordingly, for B2C supplies other than on-the-spot supplies (and supplies that may be amenable to a specific place-of-taxation rule),<sup>156</sup> the Guidelines adopt a second “residual” place-of-taxation rule for B2C supplies. Guideline 3.6 provides that “[t]he jurisdiction in which the customer has its usual residence has the taxing rights over business-to-consumer supplies of services and intangibles other than [on-the-spot supplies].”<sup>157</sup>

The use of “usual residence” as a place-of-taxation rule for B2C supplies is a quintessential “proxy.” It makes no pretense of identifying the place of actual consumption, but seeks only to make an educated guess about where private consumers are likely to consume the supplies they acquire, and their usual residence is as good a guess as any. Indeed, for the universe of B2C supplies other than on-the-spot supplies and those for which a special place-of-taxation rule might be appropriate, it is difficult to imagine a better general rule than “usual residence.”

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such a distinction must be made under the country’s VAT law. OECD, VAT/GST GUIDELINES, *supra* note 1, para 3.119, at 48.

155. *See supra* Part V(B)(1).

156. *See infra* Part VI.

157. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 3.6, at 48. A more natural, if somewhat clumsier, articulation of the rule might have described the place of taxation as “the jurisdiction in which the customer has *his or her* residence” rather than “its residence,” because the rule applies to B2C transactions where the customer is ordinarily a private person. Indeed, it is difficult to imagine where an “it,” other than a “he” or a “she” “regularly lives or has established a home.” *Id.* para. 3.123 at 48–49 (describing the jurisdiction in which a customer of a B2C transaction has “its usual residence”). Even better, at the risk of offending the grammar police, would have been “the jurisdiction in which the customer has their usual residence.” In fact, the use of the singular “they,” which has a storied history and has gained increasing acceptance, was voted 2015 Word of the Year by the American Dialect Society. *See 2015 Word of the Year Is Singular “They,”* AM. DIALECT SOC’Y, Jan. 8, 2016, <http://www.americandialect.org/2015-word-of-the-year-is-singular-they>.

The Guidelines describe the services and intangibles covered by the residual “usual residence” rule as including supplies that are likely to be consumed at a time other than when they are performed or provided, or for which the consumption and/or performance are likely to be ongoing, or that can be provided and consumed remotely.<sup>158</sup> Specifically, such supplies may include “consultancy, accountancy and legal services; financial and insurance services; telecommunication and broadcasting services; online supplies of software and software maintenance; online supplies of digital content (movies, TV shows, music, *etc.*); digital data storage; and online gaming.”<sup>159</sup>

*b. Determining the Customer's “Usual Residence”*

Once it is established that the general “usual residence” rule is applicable to a B2C supply, the “heavy lifting” begins. Initially, of course, one must determine the customer’s “usual residence.” In principle, this does not pose a serious problem, because it requires only that one determine “where the customer regularly lives or has established a home” as distinguished from a jurisdiction where customers “are only temporary, transitory visitors.”<sup>160</sup> Although there always can be circumstances in which this line is less than clear, in the overall context of the B2C Guidelines, this does not appear to be an issue that should generate much concern. The more serious problem in this regard is the practical one of how suppliers can determine a customer’s usual residence, particularly in connection with digital supplies (especially those involving high volume and low value), where the limited interaction and communication between the supplier and its customer may make it difficult for the supplier to determine the customer’s usual residence.

The Guidelines’ essential response to this problem is to urge governments to be reasonable, pragmatic, and flexible in permitting suppliers “to rely, as much as possible, on information they routinely collect from their customers in the course of their normal business activity, as long as such information provides reasonably reliable evidence of the place of usual residence of their customers.”<sup>161</sup> The Guidelines recognize that the available information may well vary depending on the type of business or product involved, and the supplier’s relationship to the customer, but that indicia of the customer’s usual residence could include information collected during the ordering process, such as the customer’s country, address, bank details, credit card information, IP address, telephone number, trading history, and language.<sup>162</sup>

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158. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.120, at 48.

159. *Id.* para. 3.122, at 48.

160. *Id.* para. 3.123, at 48–49.

161. *Id.* para. 3.126, at 49.

162. *Id.* para. 3.127, at 49.

c. *Enforcing the “Usual Residence” Rule*

Whatever may be the practical problems of determining the customer’s “usual residence” for purposes of the “residual” general place-of-taxation rule for B2C supplies, they pale by comparison to the practical problems of enforcing that rule when the supplier is not located in the jurisdiction of the customer’s usual residence, an increasingly likely scenario in the digital economy.<sup>163</sup> These problems are attributable to the fact, which the Guidelines recognize, that even if the jurisdiction of the customer’s usual residence imposes a legal obligation on the remote supplier to register in the customer’s jurisdiction and to collect the tax on the supply, “it can often be complex and burdensome for non-resident suppliers to comply with such obligations in jurisdictions where they have no business presence, and equally difficult for tax administrations to enforce and administer them.”<sup>164</sup> The lack of effective “enforcement jurisdiction”<sup>165</sup> with respect to such supplies is attributable not only to the questionable power to enforce a collection obligation against remote suppliers. It also arises because any payment obligations that jurisdictions impose directly on the private customer, notwithstanding their unquestionable legal power to impose such obligations on their residents, is unlikely to generate much revenue “in the absence of meaningful sanctions for failing to comply with such obligations.”<sup>166</sup> Despite these problems, the Guidelines conclude that “at the present time, the most effective and efficient approach to ensure the appropriate collection of VAT on cross-border business-to-consumer supplies is to require the non-resident supplier to register and account for the VAT in the jurisdiction of taxation.”<sup>167</sup>

The Guidelines have no “silver bullet” to solve all the problems associated with the recommendation that nonresident suppliers be required to register and account for VAT in the customer’s jurisdiction on cross-border B2C supplies of services and intangibles. After all, they are guidelines, not fairy tales. What the Guidelines do recommend, however, in keeping with their generally practical approach to the problems raised by VAT on cross-border trade in services and intangibles, are measures that jurisdictions can take to

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163. If the supplier is located and registered in the jurisdiction of the customer’s usual residence, collection of the VAT due on B2C supplies raises no special problems. *Id.* para 3.128, at 49.

164. *Id.*

165. See Hellerstein, *Jurisdiction to Tax in the New Economy*, *supra* note 32, (elaborating on concepts of “substantive jurisdiction” and “enforcement jurisdiction”).

166. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.130, at 50. See also *supra* Part V(A). By contrast, in the B2B context, the tax compliance obligation can effectively be shifted to the business purchaser, who is ordinarily registered for VAT purposes.

167. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.131, at 50.

encourage and facilitate compliance by nonresident suppliers with the tax collection regime in the customer's jurisdiction. Specifically, they recommend that "jurisdictions consider establishing a simplified registration and compliance regime for nonresident suppliers" in connection with cross-border B2C supplies of services and intangibles.<sup>168</sup> The simplified regime would operate separately from the traditional registration and compliance regime, without the same rights, such as input tax recovery, or obligations, such as full reporting, as in a traditional regime.<sup>169</sup> In order to assist taxing jurisdictions in developing their framework for collecting VAT on B2C supplies of services and intangibles from nonresident suppliers and to increase consistency among compliance processes across jurisdictions, which is an important concern to businesses faced with multijurisdictional VAT obligations, the Guidelines outline the principal features of a simplified registration and compliance regime for such suppliers, balancing the need for simplification and the need of tax administrations to safeguard the revenue.<sup>170</sup>

The Guidelines identify (and briefly elaborate upon) the following main features of a simplified registration-based collection regime for B2C supplies of services and intangibles by nonresident suppliers:<sup>171</sup>

- Simplified registration procedure, with required information kept to a minimum and the availability of on-line registration at the tax administration's web site;
- No input tax recovery, but nonresident suppliers could register under normal compliance regime and recover input tax according to normal rules;
- Simplified returns, with option to file electronically;
- Electronic payment methods;

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168. *Id.* para. 1.132, at 50.

169. *Id.* para. 1.133, at 50. In most cases, a nonresident supplier with no location in a jurisdiction would not incur any input tax for which it would be entitled to recovery, so that the denial of input tax recovery would not subject it to irrecoverable input tax. If a nonresident supplier were in a position where it would incur irrecoverable input tax, however, it could always choose to register under the traditional regime.

170. *Id.* para. 1.134, at 50–51.

171. *Id.* paras. 1.135–1.151, at 51–54. The Guidelines note the important role that technology plays (and will continue to play) in the tax compliance process, but deliberately focus largely on simplification of administrative and compliance procedures, in recognition of the fact that technology will be effective only if the core elements of the compliance process are sufficiently clear and simple and, in any event, that the relevant technologies will continue to evolve over time. *Id.* para. 1.137, at 51.

- Simplified and electronic record keeping requirements;
- Elimination of invoicing requirements, or issuing invoices in accord with rules of supplier's jurisdiction;
- On-line availability of all information necessary to register and comply with simplified regime;
- Use of third-party service providers to assist in tax compliance;
- Possible use of simplified regime in B2B context, if business customer is entitled to full input tax credit and jurisdiction does not differentiate between B2B and B2C supplies;
- Compliance burdens proportional to revenues involved and maintaining neutrality between domestic and foreign suppliers.

It is worth noting that a number of jurisdictions have already adopted a simplified registration and compliance regime for nonresident suppliers in connection with cross-border B2C supplies of services and intangibles. Most significantly, the European Union, which currently comprises 28 Member States, adopted such a regime in 2002 in conjunction with the so-called E-Commerce Directive, for certain electronically supplied B2C services from non-EU suppliers to EU customers, a regime that was effectively extended to equivalent intra-EU cross-border B2C services effective 2015.<sup>172</sup> The E-Commerce Directive required a non-EU supplier making on-line supplies of digital deliveries to final consumers to register, collect, and remit VAT to the relevant EU country under simplified administrative procedures. Among the key administrative simplifications were the ability of a non-EU supplier to register in a single "Member State of identification," charge and collect VAT according to the rate of the Member State where its customers reside, and pay over the amounts due to the tax administration it had elected with the tax

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172. See Council Directive 2002/38/EC of May 7, 2002 amending temporarily Directive 77/338/EEC as regards the VAT arrangements applicable to radio and television broadcasting services and certain electronically supplied services 2002, O.J. (L 128) 42; Council Regulation 792/2002, amending temporarily Regulation (EEC), No. 218/92 on administrative cooperation in the field of indirect taxation (VAT) as regards additional measures regarding electronic commerce, 2002 O.J. (L 128) 1 [E-Commerce Directive] (outlining "special scheme" for electronically supplied services). These rules are now embodied in the current EU VAT Directive, *supra* note 4, arts. 58, 358–69. See Hellerstein & Gillis, *VAT in the EU*, *supra* note 11, at 468–71.

administration reallocating the VAT revenue to the member country of the customer. In 2015, the New Zealand Government released a discussion document containing proposals for application of the GST to cross-border supplies of services and intangibles, including a requirement for offshore suppliers to register and collect GST on remote supplies of such services to New Zealand Customers.<sup>173</sup> The document notes that “[t]he proposed rules are broadly aligned with the . . . [OECD] draft guidelines.”<sup>174</sup> The proposal considers three registration options, including a “pay only” option that is described in only the most general terms but is designed to constitute a “simplified registration system” for offshore suppliers reflecting the recommendation of the OECD’s Guidelines.<sup>175</sup> Other countries have adopted or are considering adopting simplified registration systems.<sup>176</sup>

## VI. SPECIFIC RULES (B2B AND B2C TRANSACTIONS)

The Guidelines recognize that the general place-of-taxation rules for B2B and B2C transactions may not identify an appropriate place of taxation in all circumstances and that more targeted rules might be more likely to identify an appropriate place of taxation for some specifically defined circumstances. In response to this possibility, it is noteworthy what the Guidelines do *not* do. The Guidelines do not undertake to provide tax administrations with a list of specific place-of-taxation rules for application in particular circumstances where such rules might be regarded as superior to the “general” alternative. In part, this reticence reflects the recognition that the Guidelines represent “soft law,” and there is a prudential limit to the number and precision of the “rules” the Guidelines can provide without becoming overly prescriptive.<sup>177</sup> Nevertheless, there is no such limit to the guidance that the Guidelines can and do provide as to when it may be appropriate to adopt a specific rule.

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173. POLICY AND STRATEGY, INLAND REVENUE, GST: CROSS-BORDER SERVICES, INTANGIBLES AND GOODS: A GOVERNMENT DISCUSSION DOCUMENT (August 2015), <https://taxpolicy.ird.govt.nz/sites/default/files/2015-dd-gst-cross-border.pdf>.

174. *Id.* para. 1.2, at 1.

175. *Id.* para. 8.10, at 36.

176. *Id.* (mentioning Norway and Australia); *see also* Richard Krever, *News Analysis: Applying Australian GST to Online Sales*, 79 TAX NOTES INT’L 728 (Aug. 31, 2015).

177. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.163, at 57 (“It is neither feasible nor desirable to provide more prescriptive instructions on what should be the outcome of the evaluation for all supplies of services and intangibles.”).

A. *The Evaluation Framework for Assessing the Desirability of a Specific Place-of-Taxation Rule*

For the reasons suggested in the preceding paragraph and with the notable exception of supplies related to tangible property,<sup>178</sup> the Guidelines provide a framework for evaluating the desirability of a specific place-of-taxation rule rather than recommending a set of specific place-of-taxation rules for circumstances in which the general rule may lead to an inappropriate result. Guideline 3.7 thus provides:

The taxing rights over internationally traded services or intangibles supplied between businesses may be allocated by reference to a proxy other than the customer's location . . . , when both the following conditions are met:

- a. The allocation of taxing rights by reference to the customer's location does not lead to an appropriate result when considered under the following criteria:
  - Neutrality
  - Efficiency of compliance and administration
  - Certainty and simplicity
  - Effectiveness
  - Fairness.
- b. A proxy other than the customer's location would lead to a significantly better result when considered under the same criteria.

Similarly, the taxing rights over internationally traded business-to-consumer supplies of services or intangibles may be allocated by reference to a proxy other than [those provided in the general rules], when both the conditions are met as set out in a. and b. above.<sup>179</sup>

The evaluation framework for determining whether a specific place-of-taxation rule is appropriate contemplates a two-step inquiry. First, one must evaluate the merits of the general rule as applied to the type of supply in question under the criteria set forth in the Guideline. If the general rule

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178. *See infra* Part VI(B).

179. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 3.7, at 55.

produces an appropriate result, that is the end of the inquiry. However, if the general rule does not produce an appropriate result, then one must undertake an additional inquiry, which itself has two steps. First, one must evaluate the merits of the proposed specific rule under the criteria set forth in the Guideline. One must then compare the results of evaluating the general and specific rules under the Guidelines' evaluation criteria and only if the specific rule leads to a "significantly better result" should a specific rule be adopted.

The evaluation framework clearly places the burden of persuasion on proponents of a specific rule, and this is no accident. The Guidelines explicitly state their intention that "use of specific rules . . . should be limited to the greatest possible extent."<sup>180</sup> There is a good reason for this limitation, namely, that "the existence of specific rules will increase the risk of differences in interpretation and application between jurisdictions and thereby increase the risks of double taxation and unintended non-taxation."<sup>181</sup>

Although Guideline 3.7 does "not aim to identify the types of supplies of services or intangibles, nor the particular circumstances or factors, for which a specific rule might be justified,"<sup>182</sup> the Guidelines' explanatory material proceeds to do just that, offering examples of "circumstances where a specific rule may be desirable" in both the B2B and B2C contexts.<sup>183</sup> In the B2B context, as we have already pointed out,<sup>184</sup> the Guidelines suggest that the general place-of-taxation rule for on-the-spot B2C supplies might be appropriate as a special place-of-taxation rule for on-the-spot B2B supplies. Adoption of the same rule for on-the-spot supplies for both B2B and B2C supplies would relieve businesses supplying such services (e.g., restaurant services or access to events) of the compliance burden of having to distinguish between final consumers and businesses when making their taxing decisions under the general rules.<sup>185</sup> Such a special rule might thereby lead to a "significantly better result" by comparison to the application of the general rule under the criteria of efficiency, certainty, simplicity, etc.

In the B2C context, the Guidelines identify international transport as a candidate for a special rule because the general rule of physical performance for on-the-spot supplies<sup>186</sup> might lead to an inappropriate result when measured by the criteria of efficiency, certainty, and simplicity, given the fact

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180. *Id.* para. 3.160, at 56.

181. *Id.*

182. *Id.* para. 3.158, at 56.

183. *Id.* paras. 3.164–3.167, at 57–58.

184. *See* text accompanying notes 153–154 *supra*.

185. OECD, VAT/GST GUIDELINES, *supra* note 1, paras. 3.119, at 47, 3.166, at 57.

186. *Id.* Guideline 3.5, at 47 (quoted and discussed in Part V(B)(1) *supra*).

that the service is performed in multiple jurisdictions.<sup>187</sup> Similarly, the Guidelines suggest that the general rule of the customer's usual residence for other than on-the-spot supplies<sup>188</sup> might lead to an inappropriate result for services and intangibles that are performed at a readily identifiable location and require the physical presence of the person consuming the supply but not the physical presence of the person performing it (e.g., the provision of Internet access in an Internet café or a hotel lobby or the access to television channels for a fee in a hotel room).<sup>189</sup> In such cases, a special rule based on the actual location of the customer at the time of the supply might be better proxy for predicting actual consumption and for administering the VAT than a rule based on the customer's usual residence.<sup>190</sup>

### B. *Tangible Property*

While the Guidelines generally disavow any intent to identify (let alone prescribe) a specific place-of-taxation rule for particular circumstances where such a rule might lead to a better result than the applicable general rule,<sup>191</sup> when it comes to tangible property the Guidelines are a little less diffident about endorsing specific place-of-taxation rules. This simply reflects and recognizes the reality that many VAT regimes have directly or indirectly embraced place-of-taxation rules for services and intangibles based on the location of the property.<sup>192</sup> Nevertheless, as the ensuing discussion indicates, there may be less than meets the eye to the specific place-of-taxation rules for

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187. *Id.* para. 3.167, at 58.

188. *Id.* Guideline 3.6, at 48 (quoted and discussed in Part V(B)(2) *supra*).

189. *Id.* para. 3.167, at 58.

190. *Id.*

191. *See supra* note 173 and text accompanying note 182. As we have just noted, however, the Guidelines (i.e., the Guidelines' explanatory material) in substance do just that.

192. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 3.168, at 58–59. By “directly” or “indirectly,” I mean to distinguish those VAT regimes that have adopted specific place-of-taxation rules for particular types of supplies, including tangible property—*see, e.g.*, EU VAT Directive, *supra* note 4, art. 45 (place of supply for services “connected with immovable property” is “the place where the immovable property is located”); art. 52(2)(b) (place of supply for nontaxable persons for “work on movable tangible property” is where “services are physically carried out”)—with VAT regimes (like New Zealand's) that often reach a similar conclusion based on an “iterative” approach to determining the appropriate place of taxation. *See* COCKFIELD ET AL., TAXING DIGITAL COMMERCE, *supra* note 11, § 6.01[A] (elaborating on distinction between “categorization approach” and “iterative approach” to design of VAT place-of-taxation rules).

tangible property than for other place-of-taxation rules endorsed by the Guidelines.

### *I. Immovable Property*

Guideline 3.8 provides: “For internationally traded supplies of services and intangibles directly connected with immovable property, the taxing rights may be allocated to the jurisdiction where the immovable property is located.”<sup>193</sup> The first thing to notice about this place-of-taxation rule is that, unlike the Guidelines’ other place-of-taxation rules that assign taxing rights to a particular jurisdictions, the Guideline for immovable property merely contemplates the possibility that taxing rights will be assigned to particular jurisdictions. Thus while the general place-of-taxation rules for both B2B and B2C supplies identify the jurisdiction that “*has* the taxing rights” over the supplies in question,<sup>194</sup> Guideline 3.8 identifies only a jurisdiction to which “taxing rights *may be* allocated.” This permissive approach to the place-of-taxation rules is consistent with the language of Guideline 3.7, and the Guidelines’ explanation of Guideline 3.8 makes it clear that the application of Guideline 3.8 should be informed by the evaluation criteria reflected in Guideline 3.7.<sup>195</sup>

The Guidelines identify two categories of services or intangibles directly connected with immovable property regarding which “it is reasonable to assume” that the specific rule would lead to a significantly better result than the relevant general rule under the evaluation criteria of Guideline 3.7: (1) “the transfer, sale, lease or the right to use, occupy, enjoy or exploit immovable property” and (2) “supplies of services that are physically provided to the immovable property itself, such as constructing, altering and maintaining the immovable property.”<sup>196</sup> For other supplies of services and intangibles directly connected with immovable property, a phrase the Guidelines read as meaning “a very close, clear and obvious link or association between the supply and the immovable property,”<sup>197</sup> the Guidelines suggest that further evaluation under Guideline 3.7 would be required before the propriety of adopting the specific rule could be determined. These other services and intangibles would include services that are not physically performed on immovable property, but which relate to clearly identifiable, specific immovable property, such as architectural services.<sup>198</sup>

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193. OECD, VAT/GST GUIDELINES, *supra* note 1, Guideline 3.8, at 59.

194. *See id.* Guideline 3.2, at 29, Guideline 3.5, at 47, Guideline 3.6, at 49.

195. *Id.* paras. 3.170–3.174, at 59.

196. *Id.* paras. 3.173–3.174, at 59.

197. *Id.* para. 3.175, at 60.

198. *Id.* para. 3.179, at 60.

## 2. *Movable Tangible Property*

In contrast to immovable property, the Guidelines do not propose even a permissive specific place-of-taxation rule for movable tangible property. This may be explained in part by the fact that, with respect to B2B supplies of services and intangibles connected with movable property, the Guidelines view the application of the general rule based on customer location as generally leading to an appropriate result.<sup>199</sup> As for B2C supplies of services and intangibles connected to movable property, such as repairing, altering, or maintaining the property, and the rental of specific movable property where this is considered a service, the Guidelines encourage jurisdictions to consider adoption of a place-of-taxation rule based on the location of movable tangible property.<sup>200</sup> Such an approach would, according to the Guidelines “provide a reasonably accurate reflection of the place where the consumption of the services or intangibles is likely to take place and is relatively straightforward for suppliers to apply in practice.”<sup>201</sup>

## VII. MECHANISMS TO SUPPORT THE GUIDELINES IN PRACTICE

The OECD’s International VAT/GST Guidelines are not self-enforcing. Indeed, they are not “enforcing” at all, because they constitute “soft law” unless and until the Guidelines, or more realistically the guidance they embody, are incorporated into national law. In principle, this objective will be achieved, or at least pursued, through the adoption of national legislation and related implementing rules and practices that embrace the teachings of the Guidelines. In practice, however, as the Guidelines acknowledge,<sup>202</sup> even if jurisdictions seek to incorporate the Guidelines in national law or practice, there may be differences in the way jurisdictions implement or interpret the Guidelines’ neutrality or place-of-taxation principles (e.g., in determining customer status or location), or in the way they treat the specific facts of particular cross-border transactions (e.g., in the characterization of supplies), or the parties’ interpretation of the domestic rules governing a cross-border supply. When such differences occur, they may lead to double taxation, unintended non-taxation, and, in some instances, disputes. In recognition of these possibilities, the Guidelines proceed to identify mechanisms, existing and potential, that may be available to facilitate the consistent implementation of the principles of the Guidelines in national legislation, as well as their consistent interpretation by tax administrations.

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199. *Id.* para. 3.181, at 61.

200. *Id.* para. 3.180, at 61.

201. *Id.*

202. *Id.* para. 4.3., at 75.

The Guidelines encourage jurisdictions to utilize existing mechanisms for mutual cooperation, information exchange, and mutual assistance in order to support their consistent implementation under national law and practice and to deal with disputes when they may arise. In connection with such disputes, the Guidelines make it clear that formal dispute resolution mechanisms, such as those contemplated by some bilateral income tax treaties,<sup>203</sup> are not an available option for resolving disputes bearing on issues covered by the Guidelines. This is so because the formal dispute resolution mechanisms depend on the existence of a binding legal commitment between countries (i.e., hard law, such as a bilateral income tax treaty) whereas as the Guidelines constitute “soft law,” which is not legally binding. In other words, disputes simply do not “arise under” the Guidelines (as they may arise under bilateral income tax treaties) because the Guidelines themselves have no force of law and disputes bearing on issues within the scope of the Guidelines are ultimately disputes arising under one or more jurisdiction’s national law.

The Guidelines identify the following existing mechanisms for mutual cooperation, exchange of information, and other forms of mutual assistance that may aid tax administrations in interpreting and implementing the principles of the Guidelines in a consistent manner.

- The Multilateral Convention on Mutual Administrative Assistance in Tax Matters.<sup>204</sup>
- The OECD Model Tax Convention (Article 26).<sup>205</sup>

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203. See, e.g., OECD, MODEL INCOME AND CAPITAL, *supra* note 111, art. 25.

204. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 4.13, at 77. The Convention was developed jointly by the OECD and the Council of Europe in 1988 and amended by Protocol in 2010. It provides for all forms of administrative cooperation between the parties in the assessment and collection of taxes, focusing in particular on combating tax evasion and avoidance. The Convention is intended to have a very wide scope, covering all taxes, including general consumption taxes such as the VAT.

205. OECD, VAT/GST GUIDELINES, *supra* note 1, paras. 4.14–4.15, at 77; OECD, MODEL INCOME AND CAPITAL, *supra* note 111, art. 26. Although the MTC is not a binding instrument, unless and until ratified as a bilateral tax treaty (often in a form slightly different from the model), Article 26 of the MTC deals with exchange of information. It applies to “such information as is foreseeably relevant . . . to the administration or enforcement of the domestic laws *concerning taxes of every kind and description* imposed on behalf of the Contracting States” (emphasis added), including VAT. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 4.14, at 77. For countries that have adopted bilateral tax treaties based on the MTC model, along with Article 26, “the mechanism appears to offer a promising platform for Parties to exchange information both in individual cases and in broader classes of cases arising

- The Model Agreement on Exchange of Information on Tax Matters.<sup>206</sup>

Beyond the use of existing mechanisms for mutual cooperation and exchange of information, the Guidelines encourage jurisdictions to support their consistent implementation and interpretation through taxpayer services directed to the Guidelines. The Guidelines provide the following nonexclusive list of possible taxpayer services:

- the provision of readily accessible and easily understood local guidance on the domestic VAT rules that fall within the scope of the Guidelines;
- the creation of points of contact with taxing authorities where businesses and consumers can make inquiries regarding the domestic VAT rules within the scope of the Guidelines and receive timely responses to such inquiries;
- the creation of a point of contact with tax authorities where businesses can identify perceived disparities in the interpretation or implementation of the principles of the Guidelines.<sup>207</sup>

Finally, the Guidelines make it clear that they are drafted on the assumption that all parties are acting in good faith and that all the transactions are legitimate and have economic substance.<sup>208</sup> Accordingly, when this is *not* the case, i.e., in cases involving evasion or avoidance, nothing in the Guidelines may be read as preventing jurisdictions from taking “proportionate

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under VAT, including cases that raise issues implicating the Guidelines.” *Id.* para. 4.15, at 77.

206. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 4.16, at 77 (“The OECD also developed a *Model Agreement on Exchange of Information on Tax Matters* to promote international co-operation in tax matters through exchange of information. This Agreement is not a binding instrument but contains two models for *Tax Information Exchange Agreements* (TIEAs), a multilateral version and a bilateral version. A considerable number of bilateral agreements have been based on this Agreement. These TIEAs provide for exchange of information on request and tax examinations abroad, principally for direct taxes but they can also cover other taxes such as VAT. Furthermore, TIEAs provide for forms of exchange other than exchange on request.”).

207. *Id.* para. 4.18, at 77.

208. *Id.* para. 4.22, at 78.

measures to protect against evasion and avoidance, revenue losses and distortion of competition.”<sup>209</sup>

### VIII. CONCLUSION

The release of the OECD's International VAT/GST Guidelines is an enormous accomplishment. Since VAT was first adopted by a handful of countries in the 1960s,<sup>210</sup> it has spread to more than 160 countries and now generates roughly 20 percent of worldwide tax revenue.<sup>211</sup> The growth of VAT has been accompanied by the growth of international trade—particularly, in recent years, in services and intangibles. As a consequence, the need for coherent guidance regarding the application of VAT to cross-border trade in services and intangibles has become more pressing to avoid the increasing risks of double taxation and unintended non-taxation and burdens on global trade. The OECD's VAT/GST Guidelines are the culmination of twenty-year effort to fill that need. As significant as the promulgation of the Guidelines may be, however, this represents only the first step in their ultimate objective, namely, the global embrace of consistent approaches to taxation of cross-border trade in services and intangibles in accord with sound consumption tax principles. Indeed, the Guidelines may be viewed as a roadmap for future work by jurisdictions at the national level in implementing the principles set forth in the Guidelines. Moreover, the Guidelines themselves “are evolutionary in nature,”<sup>212</sup> and they will no doubt continue to change in light of future developments that will require “further updating and revision of the Guidelines.”<sup>213</sup>

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209. *Id.* para. 4.23, at 78.

210. EBRILL ET AL., MODERN VAT, *supra* note 31, at 1.

211. OECD, CONSUMPTION TAX TRENDS 2014, *supra* note 6, at 18.

212. OECD, VAT/GST GUIDELINES, *supra* note 1, para. 7, at 10.

213. *Id.*