1-1-2016

An Introduction to the OECD's International VAT/GST Guidelines

Walter Hellerstein
UGA School of Law, wallyh@uga.edu

An Introduction to the OECD's *International VAT/GST Guidelines*

WALTER HELLERSTEIN

U.S. tax professionals can benefit by becoming acquainted with the OECD's new guidelines for the design and implementation of value added tax (VAT) regimes.

On 9/27/16, the Council of the Organization for Economic Cooperation and Development (OECD) adopted a recommendation urging Member and non-Member countries alike to take account of the OECD's *International VAT/GST Guidelines*,[1] promulgated in late 2015,[2] in designing and implementing their value added tax (VAT) regimes.[3] Most American tax professionals probably greeted the OECD recommendation with a yawn, if they noticed it all. And they can hardly be blamed. After all, the United States does not have a national VAT, and U.S. subnational retail sales taxes (RSTs) are significantly different from VATs, at least in their design.[4]

Nevertheless, there are reasons why American tax professionals might benefit from at least a passing familiarity with the OECD's VAT/GST Guidelines. First, the overwhelming majority of countries in the world have adopted a VAT as their national consumption tax.[5] With the increasing globalization of trade, particularly with regard to services and intangibles at which the OECD's Guidelines are directed, American tax professionals are likely to confront—wittingly or unwittingly—questions bearing on their clients' VAT exposure with greater frequency. Second, despite the significant differences between VATs and the American subnational RSTs, there are common problems that both regimes encounter, particularly with regard to the taxation of remote sales in the digital economy, and the OECD's Guidelines may contain useful lessons for American state tax professionals, especially in light of the current controversy in the United States over the taxation of remote sales. Third, although the United States does not currently have a national VAT, proposals for adoption of a national VAT are a central feature of the national tax policy debate.[6] Acquaintance with the OECD's VAT Guidelines may facilitate an understanding of the issues surrounding the design of any future U.S. VAT. With these considerations in mind, this article seeks to provide an introduction to the Guidelines.[7]

EXHIBIT 1

Invoice-Credit Method Under 10% VAT

	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

BASIC FEATURES OF A VAT

A VAT in principle is a broad-based tax on household consumption implemented through a staged collection process.[8] Accordingly, a VAT should apply only to supplies[9] to private individuals, as distinguished from businesses, because only private individuals engage in the consumption at which the VAT is directed.[10] 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, business-to-business (B2B) transactions, and as tax collectors in final, business-to-consumer (B2C) transactions.[11] Indeed, under some VATs, businesses may be the *only* actors upon which 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.[12]

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

NOTES

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 are referred 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 The Guidelines were released in their consolidated form in November 2015 at the OECD Global Forum on VAT in Paris, France. *Third Meeting of the OECD Global Forum on VAT*, OECD, available at www.oecd.org/ctp/consumption/vat-global-forum.htm.

3 Recommendation of the Council on the Application of Value Added Tax/Goods and Services Tax to the International Trade in Services and Intangibles, C(2016)120, 27 September 2016, available at acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=345&InstrumentPID=461&Lang=en&Book=False.

4 See text accompanying notes 14-17 *infra*.

5 OECD, *Consumption Tax Trends* 14 (2014), available at www.oecd.org/tax/consumption-tax-trends-19990979.htm (hereinafter OECD, *Consumption Tax Trends*). The OECD lists 164 countries with VATs. *Id.* at 171. Although sources disagree on the precise number of countries in the world, the United Nations system classifies 195 countries between 193 member states and two non-member observer states (the Holy See and the State of Palestine). *See* "*How Many Countries Are in the World?*," WorldAtlas, available at www.worldatlas.com/nations.htm.

6 See, e.g., Leet, "Value Added Tax: Has the Time Come?,"153 Tax Notes 277 (10/10/16) (citing proposals). For a comprehensive overview of the issues raised by introducing a national VAT in the United States, see the two-volume *Symposium on Designing a Federal VAT*, 63 Tax L. Rev. 285 et seq. (2010) (Nos. 2 & 3).

7 In undertaking this task, the ensuing discussion in this article draws freely from my (and, where relevant, my co-author's or co-authors') earlier work in this area, including Hellerstein, "A Hitchhiker's Guide to the OECD's International VAT/GST Guidelines," 18 Fla. Tax Rev. 589 (2016) (hereinafter Hellerstein, *Hitchhiker's Guide*); Hellerstein, "Taxing Remote Sales in the Digital Age: A Global Perspective, 65 Am. U. L. Rev. 1195 (2016); Hellerstein, "Exploring the Potential Linkages Between Income Taxes and VAT in a Digital Global Economy," *in VAT/GST in a Digital Global Economy* 83 (Lang & Lejeune eds., 2015); Hellerstein, "Jurisdiction to Tax in the Digital Economy: Permanent and Other Establishments," 68 Bull. for Int'l Tax'n 346 (2014); Cockfield, et al., *Taxing Global Digital Commerce* (2013) (hereinafter Cockfield, et al., *Taxing Digital Commerce*); 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); Keen and 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 and Hellerstein, *Interjurisdictional Issues*); Hellerstein and Duncan, "VAT Exemptions: Principles and Practice," 128 Tax Notes 989 (Aug. 30, 2010) (hereinafter Hellerstein and Duncan, *VAT Exemptions*); Hellerstein & Gillis, "The VAT in the European Union," 127 Tax Notes 461 (Apr. 26, 2010) (hereinafter Hellerstein & Gillis, *VAT in the EU*).

8 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 1.4 (observing that "the purpose of a VAT is to impose a broad-based tax on consumption, which is understood to mean final consumption by households").

9 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.

10 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 1.2. 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, such complications will be ignored.

11 The terms "taxpayer" and "tax collector" are not used 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, the business taxpayer can recover the difference from the taxing authority in the form of a refund.

12 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, Hellerstein, and Swain, *State Taxation*, Third Edition (Thomson Reuters/WG&L, 2016 rev.) ¶ 12.01 (hereinafter Hellerstein, *State Taxation Treatise*), and is *always* the legal "taxpayer" under the use tax. *Id.* ¶ 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 7, at 397 n.123.

EXHIBIT 2

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

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 it collects on its sales (output tax).[13]

The invoice-credit method can be illustrated by the following example.[14] Assume that a 10% VAT is applied to the production and sale of notepads. Further assume that a tree farmer, who makes no purchases,[15] 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 table in Exhibit 1.

It is worth observing that the ultimate result would be no different under a RST with the same assumed facts, namely that a 10% 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.[16] 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 table in Exhibit 2.

WALTER HELLERSTEIN is the Francis Shackelford Professor of Taxation and Distinguished Research Professor Emeritus at the University of Georgia School of Law, co-author of the treatise State Taxation (Thomson Reuters/WG&L), and editor of the State & Local department for THE JOURNAL.

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."[17] 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.[18]

THE VAT AND INTERNATIONAL TRADE—THE DESTINATION PRINCIPLE

The Guidelines 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. The threshold question in this regard is whether the VAT 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.[19]

There are theoretical economic arguments that can be advanced in favor of either the destination or the origin principle,[20] 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."[21] 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.[22]

Moreover, the destination principle is the norm in international trade, is sanctioned by World Trade Organization Rules,[23] 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.

Implementing the Destination Principle

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."[24]

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 generally are taxed where they are delivered. To accomplish this goal, exported goods are commonly zero-rated[25] and imported goods are taxed at the border.[26] For the most part, border controls provide an effective mechanism for assuring collection of VATs on cross-border supplies of goods at their destination.[27] 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.[28] 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.[29]

Implementing the destination principle is more complicated with respect to the taxation of cross-border trade in services and intangibles[30] than with respect to cross-border trade in goods.

NOTES

13 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 U.S. state retail sales tax returns) are normally filed periodically (monthly, bi-monthly, or quarterly) on the basis of all relevant transactions occurring within the tax period.

14 The example is taken from Hellerstein and Duncan, *VAT Exemptions*, *supra* note 7, at 990.

15 This unrealistic (but harmless) assumption simply allows one to start the VAT chain with the tree farmer's sale rather than further "upstream" in the economic process (i.e., suppliers who sell to the tree farmer). It is also assumed 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 value" for the column labeled "sales." It also would have complicated the comparison between a VAT and a RST. See text following note 16 *infra*.

16 See Hellerstein, *State Taxation Treatise*, *supra* note 12, ¶ 14.02.

17 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 1.7.

18 *Id.*

19 The preceding two sentences are taken verbatim from the introductory chapter to the Guidelines. *Id.* para. 1.8. Quotation marks were omitted to avoid the impression that there is anything noteworthy about the Guidelines' statement of these principles.

20 See Keen and Hellerstein, *Interjurisdictional Issues*, *supra* note 7, at 360-66. The competing arguments are not rehearsed here, but they are set forth in *id*.

21 *Id.* at 362.

22 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 1.9.

23 Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the Word Trade Organization, Annex 1A, Legal Instruments–Results of the Uruguay Round vol. 1 (1994), available at www.wto.org/english/docs_e/legal_e/24-scm.pdf (providing "the 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").

24 Keen and Hellerstein, *Interjurisdictional Issues*, *supra* note 7, at 367.

25 Ebrill, Keen, Bodin, and Summers, *The Modern VAT* 184 (2001) (hereinafter Ebrill, et al, *The Modern VAT*). If a taxable supply is zero-rated, the supplier need not collect VAT on the sale of the supply, and the supply 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.

26 See 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 Tax in the New Economy*).

27 OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* 124 (2001) (hereinafter OECD, *Implementing Ottawa Taxation Framework*).

28 *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 ("Under the *destination principle*, tax is ultimately levied only on the *final consumption* that occurs within the taxing jurisdiction" (emphasis supplied)). Accordingly, "[t]hat principle is therefore entirely silent on which jurisdiction should tax business-to-business (B2B) transactions," see Keen and Hellerstein, *Interjurisdictional Issues*, *supra* note 7, at 367, because such transactions do not involve final consumption. However, as explained in more detail below, 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).

29 Keen and Hellerstein, *Interjurisdictional Issues*, *supra* note 7, at 369.

30 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/EC of 28 November 2006 on the common system of value added tax, art. 24(1) (O.J. L. 347, 11.12.2006, p. 1) (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 (in accord with the usage in the Guidelines) are referred to collectively as "intangibles." OECD, *VAT/GST Guidelines*, *supra* note 1, preface, para. 11 n.2.

Part of the problem, particularly with regard to services,[31] 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[32]—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.

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,[33] 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. However, 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.[34] Such intangible services, which may be somewhat circularly defined as services "where the place of consumption may be uncertain,"[35] or, perhaps a bit more precisely, as "services and intangible property that are capable of delivery from a remote location,"[36] 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."[37]

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. As noted at the outset of this article,[38] in late 2016 the OECD endorsed the *International VAT/GST Guidelines*, which were the culmination of nearly two decades of concerted efforts by the constituent bodies of the OECD to develop 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. The balance of this article describes the results of these efforts.

THE GUIDELINES' PLACE-OF-TAXATION RULES IMPLEMENTING THE DESTINATION PRINCIPLE

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.[39] 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."[40]

Business-to-Consumer (B2C) Supplies

There are two general place-of-taxation rules for implementing the destination principle in the B2C context.[41] 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

NOTES

31 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* note 30.

32 See, *e.g.*, EU VAT Directive, *supra* note 30, art. 43 (through 12/31/09) (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 1/1/10 with regard to B2B supplies of services and on 1/1/15 with respect to B2C supplies of services. See generally Cockfield, et al., *Taxing Digital Commerce*, *supra* note 7, ch. 5; Hellerstein and Gillis, *VAT in the EU*, *supra* note 7, at 467-71.

33 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.

34 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 1.14.

35 OECD, *Implementing Ottawa Taxation Framework*, *supra* note 27, at 24.

36 OECD, Committee on Fiscal Affairs, *Consumption Taxation of Cross-Border Services and Intangible Property in the Context of E-Commerce* (2001), reproduced in OECD, *Implementing Ottawa Taxation Framework*, *supra* note 27, at 44 [hereinafter OECD, *E-Commerce Guidelines*].

37 OECD, *Implementing Ottawa Taxation Framework*, *supra* note 27, at 25.

38 See text accompanying notes 1-3 *supra*.

39 See text accompanying notes 22-23 *supra*.

40 OECD, *VAT/GST Guidelines*, *supra* note 1, Guideline 3.1. One might note that the wording of the Guideline varies slightly from what could be regarded as a more straightforward statement of the destination principle, namely, that "[r]ules for the consumption taxation of cross-border trade *should result in taxation* in the jurisdiction where consumption takes place ....," which was the actual phraseology employed in earlier statements of the principle during the development of the Guidelines. See OECD, *Implementing Ottawa Taxation Framework*, *supra* note 27, at 231 (emphasis supplied). The change implicitly addresses the situation of 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.

41 As distinguished from the single general place-of-taxation general rule in the B2B context, see text accompanying notes 87-104 *infra*, and as further distinguished from the specific place-of-taxation rules in both the B2B and B2C contexts. See text accompanying notes 105-125 *infra*.

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.

> 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.

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.[42]

In many respects, Guideline 3.5 is an "old economy" place-of-taxation rule. Indeed, 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.[43] 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,[44] 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."[45]

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 to 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,[46] 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.[47]

The Residual "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, 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[48]), the Guidelines adopt a second, "residual" place-of-taxation rule for B2C supplies. Guideline 3.6 provides that "the 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]."[49]

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

NOTES

42 OECD, *VAT/GST Guidelines*, *supra* note 1, Guideline 3.5.

43 See text accompanying notes 30-32 *supra*.

44 "Surgeons in U.S. Perform Operation in France via Robot," *National Geographic News*, 9/19/01, available at 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.*

45 OECD, *VAT/GST Guidelines*, *supra* note 1, para 3.117.

46 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.

47 OECD, *VAT/GST Guidelines*, *supra* note 1, para 3.119. See text accompanying notes 105-25 *infra* for a discussion of specific place-of-taxation rules.

48 See text accompanying notes 105-25 *infra* for a discussion of specific rules.

49 OECD, *VAT/GST Guidelines*, *supra* note 1, Guideline 3.6. A more natural, if somewhat clumsier, articulation of the rule might have described the place of taxation as "the jurisdiction in which 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 (describing the jurisdiction in which a customer of a B2C transaction has "its usual residence").

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."

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.[50] 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."[51]

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."[52] 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."[53] 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.[54]

The challenges raised by cross-border trade in services and intangibles are the raison d'être of the OECD's VAT/GST Guidelines.

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 our increasingly digital global economy.[55] 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 nonresident 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."[56]

The lack of effective "enforcement jurisdiction"[57] 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.[58] 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 nonresident supplier to register and account for the VAT in the jurisdiction of taxation."[59]

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-

NOTES

50 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.120.

51 *Id.*, para. 3.121.

52 *Id.*, para. 3.122.

53 *Id.*, para. 3.126.

54 *Id.*, para. 3.127.

55 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.

56 *Id.*

57 See Hellerstein, *Jurisdiction to Tax in the New Economy*, *supra* note 26 (elaborating on concepts of "substantive jurisdiction" and "enforcement jurisdiction").

58 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.130. 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.

59 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.131.

border trade in services and intangibles, are measures that jurisdictions can take to 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.[60]

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.[61] 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—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.[62]

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:[63]

- 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.
- 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, in 2002, the EU, which currently comprises 28 Member States, adopted such a regime for certain electronically supplied B2C services from non-EU suppliers to EU customers in conjunction with the so-called E-Commerce Directive, a regime that was effectively extended to equivalent intra-EU cross-border B2C services effective 2015.[64] The E-Commerce Directive required a non-EU supplier making online supplies of digital deliveries to final consumers to register, collect, and remit VAT to the relevant EU country under simplified administrative procedures.[65] 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 the amounts due to the tax administration it had elected, with the tax administration reallocating the VAT revenue to the customer's Member State.[66]

In 2016, New Zealand enacted legislation (effective 10/1/16) that applies its goods and services tax (GST) to offshore suppliers making cross-border supplies of "remote" services and intangibles to New Zealand consumers.[67] The new rules require nonresident suppliers of "remote" services (including e-books, music, videos, and software purchased from offshore websites) to New Zealand consumers to register and return GST on these supplies if they exceed or are expected to exceed NZ$60,000 in a 12-month period.[68] The Special Report from New Zealand Inland Revenue describing the legislative changes notes that they "broadly follow [OECD] guidelines, as well as similar rules that apply in other jurisdictions, such as Member States of the European Union, Norway, South Korea, Japan, Switzerland[,] and South Africa."[69] The Report further notes that

NOTES

60 *Id.*, para. 1.132.

61 *Id.*, para. 1.133. 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.

62 *Id.*, para. 1.134.

63 *Id.*, paras. 1.135 – 1.151. 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.

64 See Directive 2002/38 of the Council of May 7, 2002 on the Value Added Tax Arrangements Applicable to Radio and Television Broadcasting Services and Certain Electronically Supplied Services, 2002 O.J. (L 128) 1 (EC); Council Regulation 792/2002 of May 7, 2002 on Administrative Cooperation in the Field of Indirect Taxation (VAT) as Regards Additional Measures Regarding Electronic Commerce, art. 1, 2002 O.J. (L 128) 1, 2 (EC) (the "E-Commerce Directive") (outlining the "special scheme" for electronically supplied services). These rules are now embodied in the current EU VAT Directive. EU VAT Directive, *supra* note 30, art. 58, 358–69; *see* Taxation & Customs Union, European Comm'n, Guide to the VAT Mini One Stop Shop 2 (2013), available at eeas.europa.eu/delegations/china/documents/news/0307_2_en.pdf (providing guidance on how to account for the VAT due on supplies when taxable persons supply electronic services to non-taxable persons); see also Hellerstein & Gillis, *VAT in the EU*, *supra* note 7, at 468–71 (discussing the EU's rules governing application of VAT to cross-border trade in the B2B and B2C contexts).

65 EU VAT Directive, *supra* note 30, arts. 360–62, 367.

66 *Id.*

67 Policy and Strategy, Inland Revenue, GST on Cross-Border Supplies of Remote Services 1 (2016), available at taxpolicy.ird.govt.nz/sites/default/files/2016-sr-gst-cross-border-supplies.pdf (alternatively referred to as the "Special Report").

68 *Id.*

69 *Id.* at 6.

Australia enacted similar rules that will apply beginning 7/1/17.[70]

Business-to-Business (B2B) Supplies

There are important differences in the application of the destination principle in the B2C context and in the B2B context from both a theoretical and practical perspective. Accordingly, application of the destination principle to B2B supplies warrants separate consideration.

Implementation of the Destination Principle in the B2B Context: Overview. Practical implementation of the destination principle[71] 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, and "[r]ules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place… ."[72] B2B transactions, however, generally involve business use as distinguished from final consumption.[73] Consequently, under the normal assumption that "business-to-business supplies… do not involve final consumption,"[74] 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. Although the destination principle in theory applies only to B2C transactions, it nevertheless plays an important role in the *International 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 that has been made at several points in the preceding discussion, but is important enough to repeat[75]—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."[76] 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 already made 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, it arguably is "good enough for government work, which … is what taxation is all about."[77]

Moreover, there is a theoretically defensible rationale for employing a destination-based approach for identifying the 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."[78] The use of a destination-based approach for place-of-taxation rules in the B2B context can therefore be justified theoretically as means for "implementing the destination principle," i.e., the destination-based approach for place-of-taxation rules in the B2C context.

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:

> [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.*[79]

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 likely to consume the services or intangibles supplied."[80] 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."[81]

NOTES

70 *Id.*

71 Taxing final consumption in the jurisdiction where it actually occurs. See text accompanying note 19 *supra*.

72 OECD, *Implementing Ottawa Taxation Framework*, *supra* note 27, at 5.

73 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., The Modern VAT, *supra* note 25, at 17.

74 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.2.

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

76 Keen and Hellerstein, *Interjurisdictional Issues*, *supra* note 7, at 368.

77 *Id.*

78 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.6.

79 *Id.*, para. 3.5 (emphasis supplied).

80 *Id.*

81 *Id.*

Finally, 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,"[82] the Guidelines recognize that "place of taxation rules are in practice rarely aimed at identifying where business use … actually takes place."[83] 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."[84] In short, the place-of-taxation rules "for border-crossing B2B transactions ultimately must be pragmatic."[85] 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."[86]

The General B2B Place-of-Taxation Rule: Customer Location. To facilitate implementation of the destination principle, Guideline 3.2 provides the following general 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 services or intangibles."[87] 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,[88] 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."[89] 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."[90] 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."[91] 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"), because of the truism that a single location entity can have a customer location in only one jurisdiction. If a customer has more than one location—"a legal entity that has establishments in more than one jurisdiction"[92] (a "multiple location entity" or "MLE"[93])—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.

Single Location Entities. As just noted, implementation of the B2B place-of-taxation rule based on customer location with regard to SLEs is straightforward, at least in principle, because an SLE can have a customer location in only one jurisdiction, and the determination of the customer thus determines the customer's location and the place of taxation. To be sure, there can be uncertainty as to whether a customer is an SLE or an 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";[94] 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.

Once it determined that the customer of a B2B supply is an SLE, thereby establishing the place of taxation at the customer's single location, the Guidelines' Commentary 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.[95] Under the reverse charge mechanism, the customer accounts for 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

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.

NOTES

82 *Id.*, para. 3.6.

83 *Id.*

84 *Id.*

85 Keen and Hellerstein, *Interjurisdictional Issues*, *supra* note 7, at 367.

86 *Id.*

87 OECD, *VAT/GST Guidelines*, *supra* note 1, Guideline 3.2.

88 See *id.*, para. 3.5, quoted in text at *supra* note 79, and *id.*, para. 3.9.

89 *Id.*, para. 3.9.

90 *Id.*, Guideline 3.3.

91 *Id.*, Box 3.1.

92 *Id.*, para. 3.22 (footnote omitted).

93 *Id*

94 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.22, note 24.

95 *Id.*, para. 3.47.

to be identified for VAT purposes or to account for tax in the customer's jurisdiction.[96]

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 nonresident suppliers, whether or not that supplier's customers are entitled to deduct the input tax.[97]

Multiple Location Entities. When a supply is made to an entity that has establishments in more than one jurisdiction (a "multiple location entity" or "MLE"),[98] the place of taxation cannot be determined simply by looking to the customer identified in the business agreement, as in the case of SLEs. Instead, an additional inquiry must be undertaken to determine which of the MLE's establishments has the taxing rights with respect to the supply. In this connection, Guideline 3.4 provides that, for purposes of determining the customer location of an MLE, "the taxing rights accrue to the jurisdiction(s) where the establishment(s) using the service or intangible is (are) located."[99] 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.[100]

The Guidelines recognize that there is not a one-size-fits-all approach to determining which of an MLE's establishments uses a service or intangible and where such establishment is located, and that countries take different approaches to this question.[101] Specifically, the Guidelines identify three approaches to determining the establishment of an MLE that is regarded as using a service or intangible and where the establishment is located:

- The "direct use" approach, which focuses directly on the establishment that uses the service or intangible.
- The "direct delivery" approach, which focuses on the establishment to which the service or intangible is delivered.
- The "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 with corporate tax, accounting, or other regulatory requirements.[102]

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.[103] The Guidelines and the commentary to the Guidelines elaborate further and in considerable detail on the application of each one of these methods.[104]

Specific Place-of-Taxation Rules (B2C and B2B)

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.[105] 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.

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,[106] 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

NOTES

96 *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 12, ¶ 16.01; Federation of Tax Administrators, Task Force on EDI Audit and Legal Issues for Tax Administration, Report of the Steering Committee, *Model Direct Payment Permit Regulation* 2 (2000), available at www.taxadmin.org.

97 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.64

98 See *supra* notes 92-93 and accompanying text. It is important to keep in mind that an MLE is a *single legal entity*, albeit one with multiple locations or branches, 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. 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 OECD, *VAT/GST Guidelines*, *supra* note 1, ch. 3, Annex 1 (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.

99 *Id.*, Guideline 3.4.

100 *Id.*, para. 3.6; see also *id.* para. 3.23.

101 *Id.*, para. 3.25.

102 *Id.*

103 *Id.*, para. 3.28.

104 See *id.*, paras. 3.24-3.109; see also Hellerstein, *Hitchhiker's Guide*, *supra* note 7.

105 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.163 ("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").

106 See text accompanying notes 116-25 *infra*.

> 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.[107]

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 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.

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,"[108] 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.[109] In the B2B context, 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.[110] 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[111] might lead to an inappropriate result when measured by the criteria of efficiency, certainty, and simplicity, given the fact that the service is performed in multiple jurisdictions.[112] Similarly, the Guidelines suggest that the general rule of the customer's usual residence for other than on-the-spot supplies[113] 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).[114] 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.[115]

Tangible Property. While the Guidelines generally disavow any intent to identify (let along 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,[116] 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 provided in connection with tangible property based on the location of the property.[117]

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."[118] It is worth noting that, unlike the Guidelines' other place-of-taxation rules that assign taxing rights to a particular jurisdiction, the Guideline for immovable property is merely permissive ("taxing rights *may be* allocated"), which is consistent with the language of Guideline 3.7. Furthermore, the Guidelines' explanation of Guideline 3.8 makes it clear that the application of Guideline 3.8 should

NOTES

107 OECD, *VAT/GST Guidelines*, *supra* note 1, Guideline 3.7.

108 *Id.*, para. 3.158.

109 *Id.*, paras. 3.165-3.167.

110 OECD, *VAT/GST Guidelines*, *supra* note 1, paras 3.119, 3.166.

111 *Id.*, Guideline 3.5, quoted *supra* note 42 and discussed in text following note 42 *supra*.

112 *Id.*, para. 3.167.

113 *Id.*, Guideline 3.6, quoted *supra* note 49 and discussed in text following note 49 *supra*.

114 *Id.*, para. 3.167.

115 *Id.*

116 See *supra* note 105 and text accompanying note 108 *supra*. As just noted, however, the Guidelines (i.e., the Guidelines' explanatory material) in substance do just that.

117 OECD, *VAT/GST Guidelines*, *supra* note 1, para. 3.168. The use in the text of the terms "directly" or "indirectly" is intended 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 30, art. 47 (place of supply for services "connected with immovable property" is "the place where the immovable property is located"); art. 54(2)(b) (place of supply for nontaxable persons for "work on movable tangible property" is where "services are physically carried out"), from 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 7, section 6.01[A] (elaborating on distinction between "categorization approach" and "iterative approach" to design of VAT place-of-taxation rules).

118 OECD, *VAT/GST Guidelines*, *supra* note 1, Guideline 3.8.

be informed by the evaluation criteria reflected in Guideline 3.7.[119]

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.[120] 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 supplies and the immovable property,"[121] 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 that relate to clearly identifiable, specific immovable property, such as architectural services.[122]

As for movable tangible property, the Guidelines do not propose even a permissive specific place-of-taxation rule. 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.[123] 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.[124] 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."[125]

CONCLUSION

The development 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,[126] it has spread to more than 160 countries and now generates roughly 20% of worldwide tax revenue.[127] 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 Guidelines are the culmination of 20-year effort to fill that need. Although it is premature to suggest that they should be required reading for American tax professionals, they should nevertheless be on their radar screen. This article constitutes an effort to put them there.

NOTES

119 OECD, *VAT/GST Guidelines*, *supra* note 1, paras. 3.170-3.174.

120 *Id.*, paras. 3.173-3.174.

121 *Id.*, para. 3.175.

122 *Id.*, para. 3.179.

123 *Id.*, para. 3.181.

124 *Id.*, para. 3.182.

125 *Id.*, para. 3.175,

126 Ebrill, et al, *The Modern VAT*, *supra* note 25, at 1.

127 OECD, *Consumption Tax Trends*, *supra* note 5, at 18.

Tara International

full page