Relevance of the OECD International VAT/GST guidelines for non–OECD countries

Kathryn James* and Thomas Ecker**

Abstract

The OECD International VAT/GST guidelines *(OECD Guidelines) are the most significant global attempt to coordinate place of taxation rules for cross–border supplies of services and intangibles so that the final consumption of such supplies are effectively taxed on a destination basis. However, given that the guidelines are formally a product of the OECD, it is important to assess their relevance for non–OECD countries which might have different constraints, challenges and needs to their OECD counterparts.*

This article explores the relevance of the OECD Guidelines to non–OECD countries by examining the rise of the VAT in non–OECD countries and highlighting some of the challenges and constraints that affect the realisation of tax and VAT reforms in these countries. It then examines the context and content of the OECD Guidelines with a view to these challenges and constraints. The article demonstrates that, although the guidelines are a significant step in the efforts to encourage global coordination on the taxation of cross–border supplies of services and intangibles, a number of technical,

* Senior Lecturer, Faculty of Law, Monash University. Thanks to Mel Hodge who enabled my participation at the Symposium that led to this article.

** Deputy Head of VAT Unit, Austrian Ministry of Finance; delegate to the OECD Working Party 9 on consumption taxes and its sub-bodies; Lecturer, Vienna University of Economics and Business and Faculty of Law, University of Vienna. This article was written in this author's personal capacity. The opinions expressed in this article are the author's own and do not reflect the view of the Austrian Ministry of Finance, the Austrian Government or the OECD.

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normative and administrative issues will require further review so that the guidelines are not merely relevant, but achievable for all countries with a VAT.

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1. Introduction

The value-added tax (VAT) has risen from relative obscurity in the 1950s to adoption by more than 150 countries and now accounts for approximately one-fifth of worldwide tax revenue.[1] Today non-OECD (Organisation for Economic Co-operation and Development) countries[2] constitute the vast bulk of countries with a VAT.

Expert consensus exists on what constitutes a "good VAT", which many jurisdictions aspire to but few fully realise. Such a good VAT is guided by three design norms which aim to achieve: (1) taxation of a broad base of final consumption ideally at a single rate; (2) a staged collection process providing for the refunding of VAT at each stage of the production and distribution chain — usually through the invoice-credit method; and (3) imposition of the tax on a destination basis, that is, in the country where goods and services are finally consumed.[3] This article concerns the application of the third of these norms of good VAT design and specifically the attempt by the OECD to achieve a degree of international harmonisation on this issue through the development of its *International VAT/GST guidelines* (OECD Guidelines).[4]

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1 OECD, *Consumption tax trends 2014: VAT/GST and excise rates, trends and administration issues* (2014), 18; M Keen and B Lockwood, "The value added tax: its causes and consequences" (2010) 92(2) *Journal of Development Economics* 138 at 138. This article adopts the term "VAT" rather than the interchangeable term "goods and services tax" (GST).

2 This article uses the terms "OECD countries" and "non-OECD countries" and not, eg, "developed countries" and "developing and transitional countries". This choice reflects the fact that the subject matter of the analysis is specifically focused on the OECD *International VAT/GST guidelines* and their relevance for countries outside the OECD. It is also an attempt to avoid the negative connotations that can accompany the classification of countries based on levels of economic development. The OECD also contains countries which are considered developing or middle income countries (eg, Mexico, Turkey and Chile) and non-OECD countries can include countries with high levels of development or per capita income. Nevertheless, relevant constraints that commonly affect these groups of countries are highlighted throughout.

3 For more on the idea of the "good VAT", see K James, *The rise of the value-added tax* (Cambridge University Press, 2015), chs 2–3. For confirmation of the expert consensus in relation to the destination principle, see, eg, OECD, *International VAT/GST guidelines* (2015), paras 1.2 et seq. These guidelines were endorsed by over 100 delegations at the Third Meeting of the OECD Global Forum on VAT, Paris, 5–6 November 2015: see press release and statement of outcomes, available at www.oecd.org/newsroom/oecd-delivers-international-standard-for-collection-of-vat-on-cross-border-sales.htm (accessed 22 December 2016). See also OECD/G20, *BEPS action 1: addressing the tax challenges of the digital economy, 2015 final report* (2015), 44 et seq; M van Oordt, R Stern and N Okoh, "Guidance note on value-added tax in the extractive industries" (2015), available at www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP3_AttachmentB_VAT.pdf; and for further references, see T Ecker, *A VAT/GST model convention* (IBFD Publications, 2013), 95 et seq.

4 The latest version is OECD, *International VAT/GST guidelines* (November 2015) (OECD Guidelines).

The OECD Guidelines are a response to the issue that the place of taxation rules for most VATs were designed at a time when most trade involved tangible goods that crossed customs borders and when most services were performed on the spot. All real VATs have been challenged by the explosion of trade in intangibles and services which defy traditional categorisation, do not cross traditional border controls, are difficult to trace, and where the timing and place of consumption might differ from the time of production or purchase.[5] In addition, the absence of a globally coordinated or harmonised approach means that different place of taxation rules between jurisdictions can sometimes result in either double taxation (where more than one jurisdiction's place of taxation rules tax the same supply) or non-taxation (where the place of taxation rules of more than one jurisdiction fail to tax the supply at all).[6] The OECD Guidelines therefore seek to provide an updated and uniform approach which countries might use to model their own domestic place of taxation rules. A relevant aspiration of the OECD Guidelines is that enough countries do so to enable a sufficient degree of coordination to avoid the risk of non- and double-taxation that arises as a result of inconsistent place of taxation rules.

As section 2 of this article explains, despite non-OECD countries constituting the vast bulk of VAT uptake, these countries have traditionally been the recipients, rather than the drivers, of VAT reform. The OECD Guidelines — developed primarily by OECD member countries — are no different. It therefore seems important to ask whether the OECD Guidelines offer a suitable or achievable, or at least a *relevant*, approach for non-OECD countries. The authors have deliberately chosen to assess the guidelines against the relatively low threshold of relevance, rather than a higher standard of suitability or achievability. At one level, the answer to the question of whether the OECD Guidelines are relevant for non-OECD countries must be "yes". If the OECD Guidelines themselves are sound and the goal is to encourage a uniform approach, then all who have a VAT should emulate them. However, the criterion of relevance is deliberately chosen to enable analysis of the potential costs and benefits of the OECD Guidelines to non-OECD countries at a necessarily broad level. At the same time, the criteria of relevance is sufficiently constrained to exclude a number of important prior considerations that should be undertaken if assessing the suitability or achievability of the OECD Guidelines for an individual country but which are beyond the scope of this article.

The three most important of these prior considerations are addressed briefly in turn here to give context to the issues: the first relates to the normative merits of taxing final consumption on a destination basis; the second relates to the normative merits

5 OECD, *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues* (2012), 49; R Krever, "Designing and Drafting VAT Laws for Africa", in R Krever (ed), *VAT in Africa* (Pretoria University Law Press, 2008), 9, 27.

6 OECD, *Consumption Tax Trends 2012*, above n 5, 38; for a more detailed analysis of these concepts in a VAT context including the effect of double taxation and non-taxation, see Ecker, *A VAT/GST Model Convention*, above n 3, 27.

of the VAT over other types of consumption tax; and the third is the need to consider the existing domestic context and institutional capacity of a particular jurisdiction in assessing the suitability or achievability of the OECD Guidelines for that country.

First, on the normative merits of the destination principle. The choice to tax on a destination basis might be viewed purely as a technical one which flows from the choice to levy the VAT on a consumption base. That is, if a decision is made to tax final consumption, then the country with rights to the taxation revenue arising from those acts of end consumption should be the country in which final consumption occurs. Clearly the choice to tax on a consumption base (as opposed to a base of income or wealth) is a normative choice which has long been contested and is not revisited in this article.[7] However, given that the destination principle is not just a complement to the decision to tax a consumption base but, in the context of the OECD Guidelines, is also used as a yardstick for international cooperation in the allocation of revenue from the taxation of cross-border supplies, the decision to tax on a destination basis might stand in additional need of normative, rather than purely technical, justification.

Although this article is not the place to undertake the full discussion,[8] the basis of the normative argument for applying the VAT on a destination basis would be an understanding of why final consumption generates an obligation to contribute to the revenue in the society where consumption takes place. The justification can be made in two similar, but not identical, ways. First, the classic Hobbesian[9] concept of consumption as the benefit[10] that an individual derives from the extraction or use

7 For the classic modern statement of the debate (in English), see, eg W Andrews, "A consumption-type or cash flow personal income tax" (1974) 87(6) *Harvard Law Review* 1113; A Warren, "Would a consumption tax be fairer than an income tax?" (1980) 89(6) *Yale Law Journal* 1081.

8 For the different schools of thought on the justification for VATs and more details, see Ecker, *A VAT/GST model convention*, above n 3 at 100 et seq; see also J Escolano, "Taxing consumption/expenditure versus taxing income", in P Shome (ed), *Tax policy handbook* (International Monetary Fund, 1995), 50, 51. For an illustrative example of how the different normative justifications can influence different policy decisions, see the taxation of "free" online services as discussed in S Pfeiffer, "VAT on 'free' electronic services?" (2016) 27(3) *International VAT Monitor* 158 at 163.

9 T Hobbes, *Leviathan* ([1651], 1991 ed, Cambridge University Press), 238–239.

10 See P Schmidt, *Konsumbesteuerung durch Mehrwertsteuer* (Erich Schmidt Verlag, 1999), 11 et seq and 261; R Millar, "Echoes of source and residence in VAT jurisdictional rules", in M Lang, P Melz, E Kristoffersson (eds) and T Ecker (ass ed), *Value added tax and direct taxation: similarities and differences* (IBFD Publications, 2009), 275, 294; B Terra, *Sales taxation: the case of value added tax in the European community* (Kluwer, 1988), 10; B Terra and J Kajus, *A guide to the European VAT directives* (IBFD Publications, 2009), 268 et seq; OECD, *Consumption tax trends 2008: VAT/GST and excise rates, trends and administration issues* (2008), 23.

of social product[11] provides a theoretical justification for allocating revenue to the jurisdiction where the output was used and, thus, where the consumption benefit was obtained.[12] Second, and alternatively, the obligation to pay tax in the jurisdiction where final consumption takes place might focus on the physical, legal and economic infrastructure that renders consumption possible[13] (be it the markets that enable the purchase of goods and services or the laws that protect title to goods (tangible or intangible)).[14] It is worth noting that the criterion of ability to pay[15] which is so relevant to the debate on the prior choice of a consumption base (over alternatives such as income or wealth) will not in and of itself generate a normative argument for

11 See J Stiglitz and J Rosengard, *Economics of the public sector* (4th edn, WW Norton, 2015), 473; R Doernberg, L Hinnekens, W Hellerstein and J Li, *Electronic commerce and multijurisdictional taxation* (Kluwer, 2001), 94.

12 See Ecker, *A VAT/GST model convention*, above n 3 at 102.

13 See A Schindel and A Atchabahian, "General report", in International Fiscal Association (ed), *Cahiers de Droit Fiscal International*, *vol 90a* (2005), 21, 33; see also S Cnossen, "Interjurisdictional coordination of sales taxes", in M Gillis, C Shoup and G Sicat (eds), *Value added taxation in developing countries (World Bank, 1990)*, 43, 46; B Terra, *The place of supply in European VAT (Kluwer, 1998)*, 5–6; GWJ Bruins, L Einaudi, ERA Seligman and J Stamp, *Report on double taxation: document E.F.S.73. F.19, League of Nations Economic and Financial Committee* (5 April 1923), 18 and 29; P Kirchhof, *Umsatzsteuer-Rundschau* (2002), 542 et seq; J Englisch, "VAT/GST and direct taxes: different purposes", in Lang, Melz, Kristoffersson (eds) and T Ecker (ass ed), *Value added tax and direct taxation – similarities and differences*, above n 10 at 1, 15 et seq. See also Opinion of AG Kokott, 11 January 2007, C-146/05 *Collée* [2007] ECR I-7861, point 19; M van Hilten, "The legal character of VAT", in D Albregtse and H Kogels (eds), *Selected issues in European tax law* (Kluwer, 1999), 3, 8; Millar, "Echoes of source and residence in VAT jurisdictional rules", above n 10 at 315; B Terra and J Kajus, *Commentary – a guide to the recast VAT directive*, IBFD Online (April 2016), sect 5.1.5; C Penke, *Der Ort der sonstigen Leistungen im Umsatzsteuerrecht (Driesen Rechtswissenschaft, 2008)*, 112; W Reiß, "Der Verbraucher als Steuerträger der Umsatzsteuer im Europäischen Binnenmarkt", in J Lang (ed), *Die Steuerrechtsordnung in der Diskussion, Festschrift für Klaus Tipke* (O Schmidt, 1995), 433, 439 et seq; H Stadie, in J Mössner et al (eds), *Steuerrecht international tätiger Unternehmen*, MN G 4; M Tumpel, *Mehrwertsteuer im innergemeinschaftlichen Warenverkehr (Linde Verlag, 1997)*, 186. For further analysis, references and critical reflection, see also Ecker, *A VAT/GST Model convention*, above n 3 at 108 et seq.

14 Bruins, Einaudi, Seligman and Stamp, *Report on double taxation*, above n 13 at 22 and 23; Ecker, *A VAT/GST Model convention*, above n 3 at 112 et seq.

15 See, eg, Englisch, "VAT/GST and direct taxes: different purposes", above n 13 at 22 et seq; J Englisch, "The EU perspective on VAT exemptions", in R de la Feria (ed), *VAT exemptions: consequences and design alternatives* (Kluwer, 2013), 37; H Ruppe, *Umsatzsteuergesetz Kommentar (3rd edn, 2005*), Einf MN 38; for further references to literature in German, see Ecker, *A VAT/GST model convention*, above n 3 at fn 312. See further, Bruins, Einaudi, Seligman and Stamp, *Report on double taxation, above n 13 at 21;* for more details and the debate whether consumption is to be seen as an original or indirect indicator of ability to pay, see Englisch, "VAT/GST and direct taxes: different purposes", above n 13 at 28 et seq; see also L Ebrill, M Keen, J-P Bodin and V Summers, *The modern VAT (International Monetary Fund, 2001)*, 111–112; W Reiß, "Der Belastungsgrund der Umsatzsteuer und seine Bedeutung für die Auslegung des Umsatzsteuergesetzes" in L Woerner (ed), *Umsatzsteuer in nationaler und europäischer Sicht (*Verlag Dr Otto *Schmidt, 1990)*, DStJG 13, 13 and 19–21; W Reiß, "Die harmonisierte Umsatzsteuer im nationalen

taxing on a destination basis without coupling it to one of the two arguments about how the consumption benefit is derived.[16]

Of course, consumption is an economic concept, the implementation of which is generally dependent on laws to give effect to the concept. The taxation of final consumption (or expenditure on final consumption) can be achieved in a number of different ways (such as a direct personal expenditure tax, a retail services tax (RST) or a VAT). The OECD Guidelines do not engage with the second normative issue of which is the best option to tax consumption, but instead work with the reality that the most common option in practice is the VAT. Likewise, it is beyond the scope of this article to revisit the significant debate on the relative merits of the VAT as against other options.[17] However, it is worth noting in passing that there are a number of points within the discussion that follows which could be fed back into this debate. For example, one traditional merit of the "good" VAT at a domestic level is that it has a staged collection process that is blind to the status of the purchaser — business and consumers pay the VAT alike (with business and other registered entities able to claim a refund on VAT incurred).[18] This is in contrast to the single stage retail sales tax where the onus is on retail vendors to determine the status of the customer and suspend the tax if the purchaser is a business and charge it if it is a final consumer (with a corresponding incentive for the purchaser to misrepresent their status as a business rather than consumer). The OECD Guidelines attempt to develop a system that maintains the staged collection process (a traditional merit of the good VAT) so that VAT can be effectively accounted for throughout the entire business chain (including cross-border supplies of services and intangibles between businesses where collection essentially restarts at the border). However, the recommended means to do so incorporates a distinction between business-to-business (B2B) and business-to-consumer (B2C) supplies thus potentially undermining another traditional merit of the good VAT as being blind to the status of the purchaser.[19] This might, in turn, give rise to the question of why retain the VAT at all? Why not move to an RST where the B2B/B2C distinction is also made but without the need to churn the VAT at each stage of the chain? This is not the place to engage with the significant issues raised by such a question, as interesting as they might be. For now a pragmatic reply might be that the guidelines work with the reality that there are more than 150 real VATs (rather than RSTs) in place for which

Wirtschaftsverkehr – Widersprüche, Lücken und Harmonisierungsbedarf", in R Seer (ed), *Umsatzsteuer im Europäischen Binnenmarkt (2009),* DStJG 32, 9, 12, with further references; Penke, *Der Ort der sonstigen Leistungen im Umsatzsteuerrecht*, above n 13 at 36.

16 For more details, see Ecker, *A VAT/GST model convention*, above n 3 at 102.

17 See eg G Zodrow, "The sales tax, the VAT, and taxes in between – or, is the only good NRST a 'VAT in drag'?" (1999) 52(3) *National Tax Journal* 429 at 430; Ebrill et al, *The Modern VAT*, above n 15 at 24; Krever, "Designing and drafting VAT laws for Africa", above n 5 at 13; R Bird and P-P Gendron, *The VAT in developing and transitional countries* (Cambridge University Press, 2007), 28.

18 This is the second design norm of the "good" VAT discussed above, text at n 3; see further James, *The rise of the value-added tax*, above n 3 at 72–77.

19 See the discussion at section 4.3.1 below.

attempting to maintain the VAT chain across borders matters because it complements the established domestic method of staged collection.

The VAT (like the RST) is an indirect tax levied on transactions giving rise to expenditure on final consumption. Domestic VAT laws generally do not attempt to define "consumption" as the trigger for tax liability, but rather seek to identify the transactions which give rise to expenditure on final consumption and thus trigger liability to pay VAT. At the domestic level, two design elements are key to implementing a consumption-based VAT: first, rules are needed to ensure all eligible supplies of goods and services are taxed such as rules identifying taxable transactions or supplies; and second, rules must be provided to allow all registered entities, such as business, to receive a credit for VAT paid. The intended effect of these two requirements is that, as far as possible, the final consumer bears the tax burden.

Likewise, the purpose of VAT laws at an international level is not to define consumption *per se* or even to determine where consumption takes place in an economic sense since in reality it is not always possible or practical to do so.[20] Instead, legal rules attempt to predict with sufficient accuracy at the time of supply where actual consumption is most likely to take place. This is why most VAT laws rely on proxies that apply these predictions and deem consumption to be in a specific place[21] for their place of taxation rules.[22] A simple example of this is a proxy which uses the place of performance as a proxy for the location of the consumption of a service where both the supplier and customer are in the same place at the time of the supply — such as a hairdressing service.

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20 See OECD, *The application of consumption taxes to the international trade in services and intangibles – progress report and draft principles* (2005), para 15; OECD, *Applying value added taxes to cross-border supplies of services and intangibles, emerging concepts for defining place of taxation* (January 2008), para 4. In the EU, for instance, the Second EU VAT Directive (67/228/EEC, OJ 14.04.1967, 1303/67) still referred to use and enjoyment as a place of taxation rule (see art 6(3)), but it was later considered unworkable (see, eg, European Commission, Proposal for a Council Directive amending Directive 77/388/EEC as regards the place of supply of services, COM(2003)822 final, 2). Nevertheless, art 9 of the VAT Directive of the Economic Community of Central African States (CEMAC) still assigns the place of taxation of supplies of services to be where they are used and enjoyed ("*utilisés ou exploités*"); H Kogels, "VAT on internationally traded services and intangibles – a first step toward OECD guidelines" (2006) 60(8) *Bulletin for International Taxation* 375 at 376; C Grandcolas, "VAT on the cross-border trade in services and intangibles" (2007) 13(1) *Asia-Pacific Tax Bulletin* 39 at 40; R Millar, "Jurisdictional reach of VAT", in Krever (ed), *VAT in Africa*, above n 5 at 178 et seq. For a more detailed analysis, see also Ecker, *A VAT/GST model convention*, above n 3 at 131 et seq and 135 et seq.

21 See Millar, "Echoes of source and residence in VAT jurisdictional rules", above n 10 at 293 et seq; Ecker, *A VAT/GST model convention*, above n 3 at 132.

22 For a description of the concept of "place of taxation" and the difference from "place of supply", see Ecker, *A VAT/GST model convention*, above n 3 at 133 et seq. The "place of taxation" is the result of the combination of place of supply rules, rules on zero-rating, and on the taxation of imports and hence refers to the place where a supply is actually taxed.

Therefore, the first requirement necessary to achieve taxation according to the destination principle is the development of appropriate place of taxation rules. The OECD Guidelines which provide rules for the taxation of cross-border services and intangibles mainly address this first requirement.

The second requirement for the successful application of the destination principle is the administration of these rules and especially the effective administration of border controls to impose VAT on imports and to relieve exports from VAT.

Achieving the second requirement of effective administration of VAT on imports and exports is made harder by weak border controls. As the OECD Guidelines note, making exports free of VAT and taxing imports introduces a jurisdictional breach in the staged collection process,[23] which when regularly combined with the absence of an enforcement jurisdiction,[24] increases the risk of double and especially non-taxation.[25]

For most OECD countries, weak borders have generally arisen as a result of conscious design as is the case with the removal of border controls (for intra-community trade in the European Union (EU)) or as a result of the technological advances that have facilitated the rapid expansion of global trading markets, especially with respect to digital supplies of intangible goods and services. Such goods and services might be produced through new and complex supply chains perhaps involving large multinational corporations that operate across a range of jurisdictions through complex and often opaque corporate structures.[26] Or these supplies might be performed by a sole operator providing digital services from their lounge room to customers across the world. Both these scenarios can present compliance challenges for tax administrators. With an increasingly globalised economy, non-OECD countries are not immune from these trends and will increasingly face this issue.

However, as section 2 below explains, weak border controls have long been an issue in non-OECD countries which is often the result of insufficient administrative capacity. This leads to the third prior consideration for assessing the suitability or achievability of the OECD Guidelines which stresses the need to take the context and capacity of an individual country into account in the decision to implement them. This article

23 OECD Guidelines, 1.15.

24 On the concept of enforcement jurisdiction, see W Hellerstein, "Jurisdiction to tax income and consumption in the new economy: a theoretical and comparative perspective" (2003) 38(1) *Georgia Law Review* 1 at 1.

25 For instance, when a foreign supplier provides services into another country, they would generally be liable for the full VAT in that country (unless, for example, a reverse charge is applied). There is no fractioned payment because all inputs arise in the foreign country and thus cannot be offset against the VAT liability in the destination country. If the destination country has only minimal enforcement jurisdiction, there is an increased risk of non-taxation in the case of non-compliance.

26 OECD, *Consumption tax trends 2012*, above n 5 at 49.

assesses relevance rather than suitability or appropriateness because we believe that domestic context and local institutions matter in reform and we do not wish to presuppose the suitability of the OECD Guidelines for countries for whom we are unaware of this domestic context and institutional capacity. Although some general points on taxation in non-OECD countries are made in section 2, each country should assess the relevance of the OECD Guidelines in light of their own institutional capacity and domestic context. The structure and size of the domestic economy as well as the domestic political and legal institutions through which reform is realised should be carefully considered in the analysis of the suitability of guidelines for a particular country. This is particularly so given that the OECD Guidelines have been drafted by countries at a different developmental stage and with generally more robust administrative and compliance capabilities.

This article explores the relevance of the OECD Guidelines to non-OECD countries in three further sections below. Section 2 examines the rise of the VAT in non-OECD countries and highlights some of the challenges and constraints that have been identified as issues in the realisation of tax and VAT reforms in these countries. Sections 3 and 4 examine the OECD Guidelines themselves with the former section providing some context to their operation and the latter exploring the content of the OECD Guidelines. General issues that arise within the OECD Guidelines are identified as well as potential issues that might affect non-OECD countries. Section 5 serves as the conclusion to the article and highlights the importance of international cooperation and domestic administrative capacity for the OECD Guidelines to achieve their objective of effectively taxing the final consumption of cross-border supplies of services and intangibles on a destination basis.

2. The rise of the VAT in non-OECD countries

It is among non-OECD countries that the VAT has been truly ascendant. Approximately three-quarters of countries with VAT are low to middle income countries[27] and two-thirds of the least developed countries in the world have VATs.[28] As Table 1 and Figure 1 separately show, the vast bulk of VAT uptake, particularly in non-OECD countries, occurred in the final two decades of the twentieth century.

27 Approximately 109 of the more than 150 countries with a VAT are classified as low, low to middle, or upper middle income countries. These income indicators are generally adopted as a rough proxy for developing countries: estimates based on F Annacondia and W van der Corput, "Overview of general turnover taxes and tax rates – 2012" (2012) 23(2) *International VAT monitor* 2 at 2–10; World Bank, *Country and lending groups* (2012). Available at http://go.worldbank.org/D7SN0B8YU0.

28 The UN classification of least developed countries (LDCs) includes countries that are "highly disadvantaged in their development process" and face the risk of failing to come out of poverty more than other countries. The 48 countries currently on the list of LDCs are therefore "considered to be in need of the highest degree of attention on the part of the international community": United Nations Conference on Trade and Development, *The least developed countries report 2009: the state and development governance*, UNCTAD/LDC/2009 (2009), iii.

Table 1: VAT uptake by region as at 2016[29].

	Sub-Saharan Africa[30]	Asia and the Pacific[31]	EU15 plus[32]	Central Europe and the former Soviet Union[33]	North Africa and the Middle East[34]	Americas	Small islands (population < 1 million)[35]
Countries with VAT*	38	19	21	28	9	25	14
2006–2013	5	1	0	1	2	2	9
1996–2005	18	7	0	6	1	1	3
1986–1995	13	9	9	21	4	6	2
1976–1985	1	2	0	0	2	6	0
1966–1975	0	0	11	0	0	10	0
Before 1965	1	0	1	0	0	0	0

* Out of total number of countries in region.

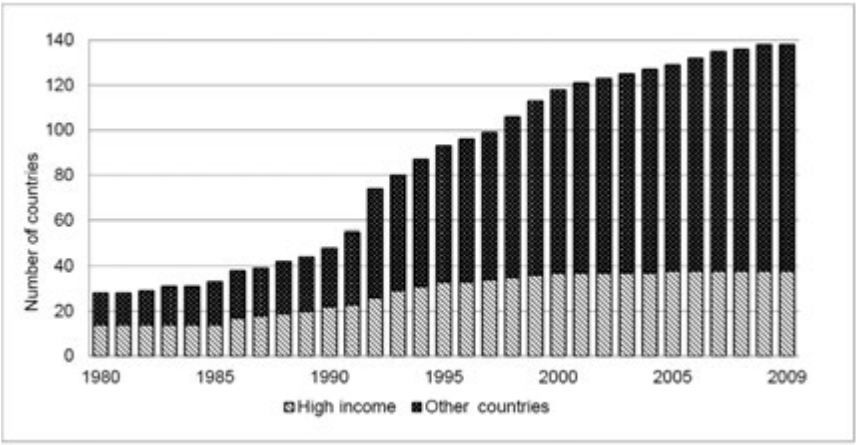
29 James, *The rise of the value-added tax*, above n 3 at Table 1.1 (country classifications based on Ebrill et al, *The modern VAT*, above n 15 at 6, 206–207).

30 Including South Sudan, which introduced a sales tax on goods and some services (hotel, bar and restaurant) in May 2013. As the tax does not take the form of a VAT, it is not counted as a VAT jurisdiction: Deloitte, "Taxation and investment: South Sudan – highlights 2015" (2015) Deloitte. Available at www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-southsudanhighlights-2015.pdf. The Gambia introduced a VAT taking effect 1 January 2013: Gambia Revenue Authority, VAT guide 2014, 6. Available at www.gra.gm/wp-content/uploads/2014/07/VAT-GUIDE_Edited_03JULY2014.pdf.

31 Modified to include Timor-Leste, which does not have a VAT, but levies a separate sales tax and services tax and is in the process of introducing a federal goods and services tax. India has sub-national VATs in most states but no federal VAT. However, at the time of writing, the federal parliament had passed the relevant constitutional amendments to enable reform to proceed. For this table, India is counted as a country with VAT: "GST to take effect from April 1: Jaitley", The Hindu (online), 10 November 2016. Available at www.thehindu.com/business/Economy/union-finance-minister-arun-jaitley-addresses-the-twoday-economic-editors-confreence-innewdelhi/article9328460.ece?utm_source=InternalRef&utm_medium=relatedNews&utm_campaign=RelatedNews.

32 EU 15 includes: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom: Ebrill et al, *The modern VAT*, above n 15, 6, 206–207, table AI.1. Additions include the micro-states, sovereign and semi-sovereign states within the European geographic zone: Andorra, Republic of Cyprus (EU member state as of 2004), Iceland, Liechtenstein, Malta (EU member state as of 2004), Monaco (applies the French VAT and is included with France), Norway, San Marino and Switzerland. Andorra and San Marino have no VAT. Liechtenstein, Iceland, Norway and Switzerland are not in the EU, but all are members of the European Free Trade Association (EFTA) and all levy VATs: Ernst & Young, *The 2012 worldwide VAT, GST and sales tax guide* (Ernst & Young, 2012), 628; OECD, *Consumption tax trends 2012*, above n 5 at 211.

Figure 1: VAT uptake according to income level 1980–2009[36]



Although the reasons behind the rapid rise of the VAT are complex,[37] two important trends are worth mentioning in the context of non-OECD countries. The first is that the locus for much of the VAT's policy development has been within OECD countries — both at an institutional and country level. Regional and international intergovernmental organisations traditionally dominated by OECD countries such

33 Many of the states within this classification have joined the EU including the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia in 2004; Bulgaria and Romania in 2007; and Croatia in 2013. The regional classification is carried over from Ebrill et al, The modern VAT, above n 15 at 6, 206–207 because it demonstrates the VAT uptake in this general geographic region following the end of the Soviet Union. Serbia (VAT introduced in 2005) and Montenegro (VAT introduced in 2003) have also been included: Annacondia and van der Corput, "Overview of general turnover taxes and tax rates - 2012", above n 27 at 2–10.

34 Bahrain, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates were expected to introduce VAT systems in 2013: OECD, Consumption tax trends 2012, above n 5 at 219. This did not occur, and Annacondia and van der Corput now estimate that VATs will be introduced in these jurisdictions (as well as Kuwait) "in the near future": F Annacondia and W van der Corput, "Overview of general turnover taxes and tax rates – 2013" (2013) 24(2) International VAT Monitor 2 at 3, 9.

35 Countries include Tuvalu but exclude the Republic of Cyprus and Malta (which have subsequently joined the EU), Iceland (which is included in the EU Plus category as it is in the EFTA) and San Marino (which is in the EU Plus category as it is a member of the Council of Europe).

36 International Tax Dialogue (ITD), *Key issues and debates in VAT, SME taxation and the tax treatment of the financial sector* (Alan Carter ed, ITD, 2013), 16 (Fig 1).

37 The reasons are often more complex than the literature admits: James, *The rise of the value-added tax*, above n 3 at ch 4.

as the European Union (EU), the OECD, the International Monetary Fund (IMF) and the World Bank have been instrumental in shaping the VAT and in promoting it to both OECD and non-OECD countries. European jurisdictions in particular have exerted a significant degree of influence on the VAT.[38] This is a consequence of a number of factors that include: (1) the fact that many European jurisdictions have led by example by virtue of being early adopters of the VAT[39] (influencing the shape of VATs introduced by later adopters either through those countries replicating the European model or attempting to depart from it); (2) the decision to adopt the VAT as the common form of sales tax in the European Economic Community (later the EU);[40] and (3) the influence of colonial legacies — with many noting the tendency of VATs in former colonies to replicate the VATs in their colonial forebears — with anglo-, franco-, hispano- and luso-phone versions of the VAT variously identified.[41] This influence has extended through OECD countries providing technical VAT advice to non-OECD countries as part of their aid and development programs.[42]

38 This is true to an extent of the OECD Guidelines, given that 22 of the 35 OECD members are at the same time EU member states. Nevertheless, the guidelines were passed with unanimity.

39 VATs were often adopted to replace existing cumulative turnover taxes. Although France is often regarded as the first jurisdiction to introduce a national VAT, France phased in the introduction of a VAT over a two-decade period — a full VAT extending to the retail sector was not introduced until 1968. Disputes as to the actual date of introduction can therefore arise based on the definition one might adopt of the VAT. Lauré is credited with developing the French tax on value-add: M Lauré, *La taxe sur la valeur ajoutée* (Paris, 1952); Ebrill et al, *The modern VAT*, above n 15 at 4; Schenk and Oldman list the date as either 1948 or 1968: A Schenk and O Oldman, *Value added tax: a comparative approach* (rev ed, Cambridge University Press, 2007), 15; A Tait, *Value added tax: international practice and problems* (International Monetary Fund, 1988), 7–8. The first full VAT in Europe was introduced in Denmark in 1967, although that country did not join the EEC until 1973. The tax replaced the Danish gross receipts tax. However, the initial VAT did not tax services in a comprehensive manner: S Cnossen, *Value added taxes in Central and Eastern Europe: a survey and evaluation* (European Commission, OECD, 1998), 424; R van Brederode, *Systems of general sales taxation: theory, policy and practice* (Kluwer, 2009), 7

40 Article 99 (ex 93) of the EEC Treaty instructed the European Commission to consider "how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation...can be harmonised in the interest of the common market": The Treaty Establishing the European Economic Community, as revised, [EEC Treaty] (Official Journal of The European Union, 2006/C321/E1); Revision of the Treaty Establishing the European Economic Community, opened for signature 25 March 1957, 298 UNTS 11 (entered into force 1 January 1958). The current directive attempting to realise this is a recast of the Sixth Directive: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L 347/1 [hereinafter the EU VAT Directive (2006/112/EC)].

41 S Cnossen, "Mobilizing VAT revenues in African countries" (2015) 22(6) *International Tax and Public Finance* 1077 at 1085; Jean-Paul Bodin and Vincent Koukpaizan, "The rise of VAT in Africa — impact and challenges" (2009) 20(3) *International VAT Monitor* 178 at 180.

42 James, *The rise of the value-added tax*, above n 3 at 175–176.

The second trend complementing the first is that, as was previously noted, the vast bulk of VAT uptake has occurred in non-OECD countries. It is perhaps no coincidence that the growth of VAT among non-OECD countries occurred in the last two decades of the twentieth century. As Table 1 shows, part of this uptake was a consequence of the fall of the Soviet Union and the need to finance new states. Budgetary problems and the resulting pressure to find new ways of financing likely also played a role for other countries. Although this explains the need for reform in these jurisdictions, it does not explain *why* the VAT was the option adopted time and again in these transitional and developing countries. For many countries, part of the answer might lie in a trend that Goode highlights of a shift within the IMF from providing assistance throughout the 1960s to linking assistance to various adjustment and lending programs in the 1980s and 1990s.[43] At the same time, the World Bank focused more heavily on the revenue side of fiscal policy and increased its involvement in taxation advice and linked funding to tax reform.[44] The content of advice also changed over this period with expert consensus within these organisations increasingly favouring a greater reliance on general consumption taxes over alternatives such as trade taxes and even the income tax.[45] With the VAT regarded as the best available method to tax consumption, both of these organisations have made the adoption of VAT a key component of their advice and assistance programs.[46] The IMF in particular has prioritised the VAT as an important part of its development agenda designed to strengthen revenue performance.[47] Thus, the VAT has been offered as a policy "fix" in all sorts of contexts — from the need to fund the new state in transitional economies to the need to replace tariffs and trade taxes across much of the developing world.

The combination of these two trends reveals that, as with many instances of policy convergence, non-OECD countries generally have been the recipients rather than the drivers of reform. This is also the case with the development of the OECD Guidelines (see section 3 below). However, in many respects, the problems experienced by OECD countries, to which the OECD Guidelines are a response, have long been issues in non-OECD countries, that is, a loss of revenue arising from lack of effective border controls. For OECD countries, this is due to an increase in cross-border supplies of services and intangibles combined with taxation rules that were mainly designed for domestic services. Although these factors similarly affect non-OECD countries, a lack of effective control over borders is also often the product of a lack of administrative capacity. As explained in the introduction, this article cannot account for all the factors

43 R Goode, "Tax advice to developing countries: an historical survey" (1993) 21(1) *World Development* 37, 40.

44 Ibid.

45 Ibid 41, 49; James, *The rise of the value-added tax*, above n 3 at 167–168.

46 World Bank, *Lessons of tax reform* (World Bank, 1991), 67.

47 International Monetary Fund (IMF), "Current challenges in revenue mobilization: improving tax compliance", Staff Report (April 2015), 46; C Ebeke, M Mansour and G Rota Graziosi, "The power to tax in sub-Saharan Africa: LTUs, VATs, and SARAs", Ferdi working paper no. 154 (June 2016), 3.

that will affect the suitability or achievability of the OECD Guidelines for non-OECD countries, but some preliminary observations on the factors often relevant to tax reform and administration in these jurisdictions will be identified here as a basis for assessing the relevance of the OECD Guidelines for non-OECD countries.

First, to give effect to the observation that domestic institutions matter in achieving any lasting reform, we do not assume that the diverse range of countries that might fall within the broad category of "non-OECD" face the same constraints and opportunities. There is indeed great variation within specific regions — the African continent is a good example of this diversity. Within Africa is an entire range from high conflict countries with limited administrative capacity, such as South Sudan, to the relative sophistication of the South African Revenue Service (SARS). Non-OECD countries include countries that rely primarily on aid for revenue, countries where foreign direct investment is growing in scope (as is the case in many parts of Latin America) as well as the world's second largest national economy — China.[48] The group includes countries with significant potential economic growth in areas that can prove challenging for VAT implementation, such as the extractive industries,[49] telecommunications and agriculture,[50] as well as small island nations with limited export opportunities and a relatively small final consumption base.

Second, as with much of the OECD, non-OECD countries have all adopted "real VATs". These are VATs which depart in various ways from the consensus on good VAT design.[51] To the extent that the departures from the good VAT result in taxes which bear the name VAT but which do not in fact tax domestic consumption — either by deliberate design (for example, through operating a turnover tax or a single stage sales tax) or in practice (through denying credit for refunds on inputs which in practical terms renders the "VAT" a turnover tax)[52] — the OECD Guidelines might not apply at all (as section 4.1 explains). However, even if the OECD Guidelines can apply, one particular issue that will affect the application of the guidelines is the extensive use of exemptions in the real VATs of many non-OECD countries (see section 4.3.1). [53]

48 I Johanna Mosquera Valderrama, "The OECD-BEPS measures to deal with aggressive tax planning in South America and Sub-Saharan Africa: the challenges ahead" (2015) 43(10) *Intertax* 615 at 620–621.

49 See, eg, van Oordt, Stern and Okoh, "Guidance note on value-added tax in the extractive industries", above n 3.

50 Valderrama, "The OECD-BEPS measures to deal with aggressive tax planning in South America and sub-Saharan Africa", above n 48 at 620–621.

51 James, *The rise of the value-added tax*, above n 3 at ch 3.

52 See, eg, Ebeke et al who note that significant limitations are placed on VAT refunds in sub-Saharan African countries: Ebeke, Mansour and Rota Graziosi, "The power to tax in Sub-Saharan Africa: LTUs, VATs, and SARAs", above n 47 at 24.

53 Cnossen notes the large use of exemptions in African VATs: Cnossen, "Mobilizing VAT revenues in African countries", above n 41 at 1086–1087.

Third, a longstanding theme from the literature on tax reform in many non-OECD economies is that poor administrative capacity and compliance gaps are a major barrier to successful and lasting reform. This is certainly the case with the VAT. VAT revenue ratios (VRR)[54] are calculated at little more than 30% of the potential consumption base in non-OECD countries compared to an average of around 50–60% in OECD countries.[55] Although estimates of VAT gaps (the difference between the VAT that should in theory be collected under the existing VAT law and the revenue actually collected) in non-OECD countries are rare, existing studies reveal much higher VAT gaps than in most OECD countries. For example, estimates suggest a VAT gap of around 14% across the Europe Union[56] and 30% in Latin America. Estimates of the VAT gap in sub-Saharan Africa range from 10% for South Africa to more than 60% for Uganda.[57]

Common issues faced by many non-OECD countries that contribute to these poor outcomes include insufficient resourcing of revenue departments,[58] lack of qualified staff (with VAT revenue performance positively correlated with increased literacy levels)[59] and poor pay or inappropriate remuneration incentives for existing staff

54 The VAT revenue ratio measures VAT collections as a percentage of total domestic consumption (excluding VAT from the final value of domestic consumption): M Keen and B Lockwood, "Is the VAT a money machine?" (2006) 59(4) *National Tax Journal* 905 at 908. The OECD developed the C-efficiency ratio but has now adopted the VRR: OECD, *Consumption tax trends 2012*, above n 5 at 106, 104–11.

55 Bird and Gendron, *The VAT in developing and transitional countries*, above n 17 at 121–122; Cnossen estimates an average VRR ratio of 0.39 for VATs in Africa ranging from 0.11 in Cote d'Ivoire, Ethiopia and Niger to 0.67 in South Africa and 0.87 in the Seychelles: Cnossen, "Mobilizing VAT revenues in African countries", above n 41 at 1089.

56 Institute for Advanced Studies, "Study and reports on the VAT gap in the EU-28 member states: 2016, final report, TAXUD/2015/CC/131". Available at https://ec.europa.eu/taxation_customs/sites/taxation/files/2016-09_vat-gap-report_final.pdf, which is a study for the European Commission looking at the years 2013 and 2014.

57 In measuring the difference between the revenue that should be collected under existing laws and the revenue that is actually collected, the VAT gap can reflect weak administrative capacity but also captures factors that may not directly reflect poor administrative capacity, such as unrecovered VAT debts arising from insolvency. IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47 at 10, 14–15.

58 The IMF notes that the headquarters of the revenue authorities in many countries are understaffed and lack sufficient power to centralise and coordinate collection — often falling short of the benchmark of 5% of total staff in headquarters. This fragmentation across provincial authorities as well as security services and transport authorities leads to weaker collections: IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47 at 33.

59 Literacy has a powerful positive association with VAT yield: International Tax Dialogue, *Key issues and debates in VAT, SME taxation and the tax treatment of the financial sector*, above n 36 at 19.

exacerbating the risk of corruption.[60] VAT compliance continues to be hampered by large agrarian sectors,[61] the presence of large informal economies,[62] fraud, corruption[63] and significant compliance costs.[64] As an example of the extent of the problem for some jurisdictions, Kazakhstan has recently proposed converting its VAT to a turnover tax because refund fraud is so endemic that the government is frequently a net-debtor to taxpayers.[65] All these factors hamper the principles of good tax administration that the OECD Guidelines suggest are needed to ensure neutrality in the application of any VAT and especially with respect to cross-border supplies.[66] Furthermore, it has been shown time and again that poor outcomes (in this instance, departures from the three norms of good VAT design) can result if insufficient attention is paid to the resource and other constraints these countries face. This point might be evidenced by the widespread practice in many non-OECD countries of delaying or denying VAT refunds on otherwise eligible exports (which in fact turns the VAT into the type of trade tax or business tax it is designed to replace).[67]

Interestingly, however, the need to build administrative and compliance capacity has gained renewed attention in OECD countries since the global financial crisis. As the IMF notes, "[l]ong a central concern in developing countries, strengthening

60 IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47 at 34. The IMF report identifies the risk that performance pay based on collection levels increases the risk of corruption as bribes might be paid to avoid over-assessment.

61 The size of the agrarian sector can be a proxy for levels of development but the sector is also notoriously difficult to tax — Keen and Lockwood note that this is particularly the case with the VAT: Keen and Lockwood, "The value added tax: its causes and consequences", above n 1 at 143.

62 The informal sector is estimated to be between 30–60% of GDP in developing and transitional economies: Bird and Gendron, *The VAT in developing and transitional countries*, above n 17 at 74.

63 See, eg, IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47 at 17.

64 The *Paying taxes* report estimates that the sample taxpayer in that study spent 99 hours complying with consumption tax obligations, 92 hours for labour taxes and 65 for the corporate income tax: World Bank Group and PricewaterhouseCoopers, *Paying taxes 2017* (PWC & World Bank, 2017), 37, 40.

65 A Zhabbarov, "Kazakhstan – transition from VAT to sales tax: a unique experience?" (2016) 56(8) *European Taxation* 361 at 361.

66 OECD Guidelines, 2.26, box 2.1.

67 Ebrill et al note that "the processing of refunds in relation to exports is one of the most problematic features of the VAT in developing countries": *The modern VAT*, above n 15 at 195, and 66–67; International Tax Dialogue, "The value added tax: experience and issues", background paper prepared for the International Tax Dialogue conference on the VAT, Rome, 15–16 March 2005 (2005), 31; G Harrison and R Krelove, "VAT refunds: a review of country experience", IMF working paper no. WP/05/218 (2005), 14. According to an OECD survey, 80% of businesses cannot fully recover their foreign VAT: OECD, *VAT/GST relief for foreign businesses: the state of play, a business and government survey* (February 2010), 19; see further A Charlet and S Buydens, "VAT and GST refunds", *The Tax Journal*, 3 September 2009, 21 at 21ff; OECD, *Consumption tax trends 2008: VAT/GST and excise rates, trends and administration issues* (2008), 35–36.

compliance has become a greater priority in many advanced and emerging economies since the financial crisis …".[68] To the extent that this increased focus on compliance in OECD countries might lead to a greater effort to capacity build in this space, then perhaps non-OECD countries might also benefit. In the case of the OECD Guidelines, this might occur as a result of the efforts to improve cooperation and coordination among tax administrations (see section 4.4 of this article). Nevertheless, this renewed focus on compliance has also increased pressure on many non-OECD countries with reports that countries in sub-Saharan Africa and South America are facing challenges implementing new international rules relating to various components of the OECD's base erosion and profit shifting (BEPS) action plan.[69] Valderrama warns that revenue administrations in South America and sub-Saharan Africa might be overwhelmed by these new obligations without increased administrative resources and capacity building to support them.[70]

Finally, given that the VAT is a significant source of revenue for many non-OECD countries, it is important to get the settings right. There is a particularly strong case for developing an appropriate response to the taxation of cross-border supplies in the context of non-OECD countries because for many of them, a significant portion of revenue is collected at the border on imports.[71] So much so that it has been remarked of some VATs in the developing world that rather than operate as broad-based taxes on domestic consumption, they effectively operate as "select excises"[72] or "border taxes".[73] Non-OECD countries therefore have a great deal at stake as the nature of global trade continues to change and the ability to police these borders becomes increasingly challenging.

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68 IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47 at 6. The report notes that many revenue administrations in developed countries have faced significant funding cuts and were caught out from a focus on encouraging voluntary compliance at the expense of effective audit and enforcement.

69 Valderrama, "The OECD-BEPS measures to deal with aggressive tax planning in South America and sub-Saharan Africa", above n 48 at 623.

70 Valderrama identifies further challenges with implementing BEPS action plans on the digital economy, hybrid mismatches, redefinition of the concept of permanent establishment and the introduction of complex tax treaty abuse provisions such as limitation of benefits: Valderrama, "The OECD-BEPS measures to deal with aggressive tax planning in South America and sub-Saharan Africa", above n 48 at 623–624.

71 Cnossen, "Mobilizing VAT revenues in African Countries", above n 41 at 1088; Ebrill et al, *The modern VAT*, above n 15 at 50.

72 Cnossen, "Mobilizing VAT revenues in African countries", above n 41 at 1077.

73 Remark made by the IMF in relation to the VAT in Uganda: Cnossen, "Mobilizing VAT revenues in African countries", above n 41 at 1088, fn 14. Cnossen claims that VATs, trade taxes and excise duties account for approximately two-thirds of total tax revenue in low income African countries with half of VAT revenues collected at the import stage and the remainder from producers of traditionally excisable products: ibid at 1088.

3. History and legal value of the OECD Guidelines

3.1 History of the OECD's work on consumption taxes

Historically, the VAT has received very little attention from the OECD. This might be explained by the fact that it is a rather young tax, at least compared to the income tax, and that it is not used by all OECD member states, most notably the United States (US). While recognition of the VAT's importance is steadily growing within the OECD, arguably it does not receive the recognition it should, at least compared to its budgetary importance for OECD member countries and other countries around the world.[74]

On the creation of the OECD Fiscal Committee (the predecessor to the OECD Committee on Fiscal Affairs (CFA)) in 1956, turnover taxes came within the scope of the OECD's work.[75] However, the first significant piece of work on VAT was not carried out until the development of the Ottawa Framework Conditions, which were adopted in 1998.[76] While this product focused on electronic commerce, it provided the basis for all subsequent work. For instance, it enshrined the destination principle in providing that the "[r]ules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place".[77] Today, this destination principle (the third norm of good VAT design) remains at the core of the OECD Guidelines.[78] 1998 also saw the CFA establish the Working Party No. 9 on Consumption Taxes (WP9).[79] It has been this working party — supported by its technical advisory group (TAG) — that has, among other things, developed the OECD Guidelines.[80]

In July 2015, the CFA approved a consolidated version of the OECD Guidelines, which were endorsed at the OECD Global Forum on VAT in November 2015 by

74 OECD, *Consumption tax trends 2014*, above n 1, 18.

75 The OECD Fiscal Committee (predecessor of the CFA) was charged with the assignment to "determine, and make concrete proposals to the Council on, principles to be applied by them in order to avoid double taxation", whereby the study should cover, inter alia, "[b]y which means can double taxation be avoided where the same transaction is subject to turnover tax in several Member countries": Organisation for European Economic Cooperation (as the OECD then was) (OEEC), Council Resolution Creating a Fiscal Committee, 19 March 1956, C(56)49 (final), 2; for more detailed information and further references, see Ecker, *A VAT/GST model convention*, above n 3, 75.

76 OECD, *Electronic commerce: taxation framework conditions* (1998); for more information, see, eg, W Hellerstein, "A hitchhiker's guide to the OECD's international VAT/GST guidelines" (2016) 18(10) *Florida Tax Review* 589 at 602 et seq.

77 OECD, *Electronic commerce: taxation framework conditions*, above n 76, 5.

78 See OECD Guidelines, guideline 3.1.

79 See OECD, *Directory of OECD intergovernmental bodies 2007* (2007), 274.

80 For a more detailed description of the development process of the guidelines, see Hellerstein, "A hitchhiker's guide to the OECD's international VAT/GST guidelines", above n 76 at 602ff.

delegations of 104 jurisdictions and international organisations "as standards for the VAT treatment of international trade in services and intangibles, to serve as a reference point for designing and implementing legislation with a view to minimising the potential for unintended non-taxation and double taxation".[81] In parallel, a part of the OECD Guidelines also represents an output under the OECD/G20 BEPS action 1.[82] On 27 September 2016, the OECD Guidelines were adopted as a recommendation by the OECD's highest decision-making body, the OECD Council.[83]

3.2 Involvement of non-OECD countries

In the OECD Council, as well as the CFA or WP9, decisions are made by OECD member countries. Thus, formally the OECD Guidelines are based on decisions of these member countries. However, this does not mean that non-OECD countries have had no involvement in the development of the OECD Guidelines. Next to the OECD member countries, a number of accession and observing countries from all continents have participated in the meetings of the decision-making bodies. Organisations experienced in dealing with non-OECD countries, such as the IMF, were also involved, although of course these organisations cannot represent non-OECD countries.

Non-OECD G20 countries and candidate members contributed to the parts of the OECD Guidelines that were also included in the BEPS package as BEPS associates on an equal footing with OECD members (ie with the same rights of approval or reservation as OECD members). So, for example, non-OECD countries acted as BEPS associates in developing the OECD Guidelines on the place of taxation[84] and in the work on the low value goods imports that were included in the BEPS package.[85]

Non-OECD countries have been able to give further input at four global fora on VAT[86] with high-level representatives from about 100 jurisdictions and international

81 See Third Meeting of the OECD Global Forum on VAT Paris, 5–6 November 2015, above n 3, statement of outcomes.

82 OECD/G20, *BEPS action 1: addressing the tax challenges of the digital economy*, above n 3, 82 et seq, 119 et seq and annex D (221 et seq), where reference is especially made to chapter 3 of the OECD Guidelines concerning the place of taxation for cross-border supplies of services and intangibles.

83 OECD, Recommendation of the Council on the Application of Value Added Tax/Goods and Services Tax to the International Trade in Services and Intangibles, 27 September 2016 – C(2016)120. Available at http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=345&InstrumentPID=473&Lang=en&Book=False (hereinafter OECD, VAT Council Recommendation).

84 That is, chapter 3 of the OECD Guidelines.

85 These non-OECD members/BEPS associates were Argentina, Brazil, China, Colombia, India, Indonesia, Latvia, Lithuania, Russian Federation, Saudi Arabia and South Africa: see n 82, above.

86 OECD Global Forum on VAT with events held on 7–8 November 2012 in Paris, 17–18 April 2014 in Tokyo, and 5–6 November 2015 and 12-14 April 2017 in Paris.

organisations taking part. Each global forum served, among other roles, as a platform to present, discuss and obtain feedback about the OECD Guidelines at a global level. Input was also received during the numerous events held around the world in the framework of the OECD Global Relationship Program.[87] Academic and professional conferences attended by representatives of the OECD have also provided informal opportunities for representatives of non-OECD countries to obtain information and offer feedback on the guidelines.[88]

As a result of this relatively modest involvement, non-OECD countries have been able to exercise at least some minor influence on the content of the OECD Guidelines. For example, without the input of non-OECD countries, the OECD Guidelines would probably simply contain a recommendation to apply the reverse charge mechanism to all B2B supplies. However, the reverse charge mechanism rests on distinguishing B2B supplies (for which the mechanism is appropriate) from B2C supplies (for which the mechanism is not appropriate).[89] Although the B2B/B2C distinction is familiar to, and indeed adopted in, many OECD member countries, a number of non-OECD countries highlighted that many countries do not distinguish between B2B and B2C supplies and thus could not effectively run a reverse charge for B2B supplies. As a result, the OECD Guidelines were adapted to recognise that the reverse charge is only recommended where this is consistent with the overall design of the national consumption tax system.[90]

Another example of the influence of non-OECD countries might be the role of guideline 3.5 which provides that the place of taxation for on-the-spot supplies is the place of performance of the supply (see section 4.3.2). One could argue that the way this guideline is phrased and put into effect, it is in fact a specific rule. However, it was made a general rule due to the existing widespread use of the rule, especially in non-OECD countries where it sometimes constitutes the *only* place of taxation rule.[91] Two consequences flow from this. The first is that this is favourable from a revenue perspective because the rule permits revenue to remain in the non-OECD

87 See for further information: www.oecd.org/ctp/tax-global/.

88 For example, the annual congresses of the International Fiscal Association (IFA) and events hosted by the Institute for Austrian and International Tax Law of the Vienna University of Economics and Business (WU) which were attended by members of the OECD Secretariat as well as members from non-OECD countries: see listing of events at Institute for Austrian and International Tax Law, "Conferences on VAT/GST", Vienna University of Economics and Business, available at www.wu.ac.at/en/taxlaw/eventsmain/international-conferences/conferences-on-vatgst/.

89 The reverse charge mechanism which requires the customer to both charge and pay the VAT is explained in greater detail in section 4.3.1 below.

90 See section 4.3.1 below for more details.

91 This rule is used in one form or another to determine the place of taxation by almost all jurisdictions. In many countries, these services represent a large part of B2C services (eg compared to remote services) and thus an important amount of VAT revenue stems from these services (often, for example, in countries that rely heavily on tourism).

country where the on-the-spot supply was performed. This can be a significant source of revenue for non-OECD countries with large tourism sectors (see section 4.3.2). Second, phrasing the rule as a general, rather than specific, rule means that countries can apply it without needing to resort to the evaluative criteria to justify the application of a specific rule in guideline 3.7 (see section 4.3.3).

Despite the attempts to involve non-OECD countries, the OECD Guidelines nevertheless remain a product of the OECD.[92] However, as the next section explains, this does not mean that the guidelines have no relevance to non-OECD countries.

3.3 Legal "value" and practical importance of the OECD Guidelines

The OECD Guidelines have been adopted as an OECD Council recommendation and are therefore not legally binding. Despite being a formal product of the OECD, the addressees of the guidelines are all jurisdictions. The intention is that they will voluntarily decide to comply with the OECD Guidelines, for example, by issuing appropriate rules at the national level. For that reason, the OECD guidelines operate at a high level of generality with individual jurisdictions that choose to follow them left to fill in the detail. Countries that do not follow the OECD Guidelines do not fail any legal obligations and — at least from a legal point of view — there are no foreseeable repercussions in cases of non-compliance. The OECD Guidelines are therefore an instance of "soft law". [93]

In keeping with the status of the OECD Guidelines as soft law, the stated objective of the guidelines is "to assist policy makers in their efforts to evaluate and develop the legal and administrative framework in their jurisdictions", rather than to aim at prescriptions for national legislation. This acknowledges that jurisdictions are sovereign with respect to the design and application of their laws.[94] The non-binding character of the OECD Guidelines gives states the liberty to deviate from them in order to take account of the legal, economic, political, social or other special circumstances of their particular state.[95] However, in an effort to facilitate a coherent application of national VAT legislation to international trade and to minimise the potential for double or non-taxation, the OECD Council recommends that jurisdictions "take

92 Chapter 3 also being a product of G20 and BEPS associates.

93 Pistone defines "soft law" as a broad legal category "which includes any type of social rule or any principle lacking an actual binding force, but nevertheless capable of exercising some kind of suasion on the addressees to comply with it on a voluntary basis". Soft law need not necessarily be issued by a sovereign entity or state. Still, it derives its strength from the fact that states and sovereign entities share its content, substance and goals: P Pistone, "Soft tax coordination: a suitable path for the OECD and the European Union to address the challenges of international double (non-)taxation in VAT/GST systems", in Lang, Melz, Kristoffersson (eds) and T Ecker (ass ed), *Value added tax and direct taxation – similarities and differences*, above n 10, 1161, 1165.

94 See OECD Guidelines, preface para 6.

95 See OECD Guidelines, 54 et seq.

due account of the Guidelines […] when designing and implementing legislation".[96] When developing VAT legislation, adherents are encouraged to "[p]ursue efforts to implement the principles" contained in the guidelines and to use the guidelines as a source of reference when applying them in practice.[97] Two important principles include the principle of VAT neutrality (see section 4.2 below) and the destination principle (see section 4.3).

Although not legally binding, soft law often gains significant relevance for factual, economic, political or other reasons. In the taxation area, the power of soft law can be demonstrated by two existing OECD Council recommendations — the OECD *Model Tax Convention on Income and on Capital*[98] and the OECD *Transfer pricing guidelines for multinational enterprises and tax administrations*[99] — or by the United Nations *Model Double Taxation Convention between Developed and Developing Countries*.[100] The model conventions, for instance, are the general starting point for treaty negotiations and deviations requested by one of the negotiating partners are seldom accepted without a reciprocal concession elsewhere. Similarly, the transfer pricing guidelines are the closest approximation to a global standard on that issue.

The endorsement of the OECD Guidelines at the third OECD Global Forum[101] and the possibility of non-OECD countries formally adhering to the guidelines[102] show the early influence of the OECD Guidelines in this way, as do moves by select jurisdictions to implement them.[103]

96 OECD, VAT Council Recommendation.

97 OECD, VAT Council Recommendation.

98 OECD, *Model Tax Convention on Income and on Capital* (2015).

99 OECD, *Transfer pricing guidelines for multinational enterprises and tax administrations* (2010).

100 Available at www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf (30 September 2016).

101 See n 81, above.

102 See OECD, VAT Council Recommendation; by adhering to the OECD Guidelines, a country formally expresses its commitment to pursue efforts to implement the principles contained in the guidelines (see also section 3.3 above).

103 See, eg, Australia and New Zealand have introduced reforms to implement key components of the OECD Guidelines: see, for example, the legislative changes to the *A New Tax System (Goods and Services Tax) Act 1999* (Cth), eg Subdivs 84-B to 84-D, introduced by the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016* (Cth); s 8B of the *Goods and Services Tax Act 1985* (NZ). As of 1 December 2016, India has introduced taxation of business to consumer supplies of online information, data access and retrieval (OIDAR) (B2B supplies of such services were already taxed under a reverse charge): see notifications nos 46/2016-ST, 47/2016-ST, 48/2016-ST and 49/2016-ST, all dated 9 November 2016. Other jurisdictions such as Albania, Japan, Kenya, Korea and New Zealand have also introduced related reforms: for an overview concerning e-services, see http://ebiz.tax/overview-global-digital-ecommerce-tax/.

If states wish to prevent disparities in a binding "hard law" framework, which then could also include mechanisms for dispute resolution,[104] they would need to negotiate and conclude a VAT treaty. While such a treaty could be based on the principles underlying the OECD Guidelines, the guidelines by themselves are not suited as a model convention.[105]

4. Relevance of the OECD Guidelines for non-OECD countries

This section addresses the relevance of the OECD Guidelines in four parts: first, by explaining their scope and application; second, by addressing the underlying principle of neutrality that both informs and constitutes a core component of the OECD Guidelines; third, by detailing the main content of the guidelines, which are the place of taxation rules for cross-border supplies of services and intangibles; and, finally, by outlining the importance of international cooperation and domestic administration in giving effect to the guidelines.

4.1 Scope of the OECD Guidelines

While most non-OECD countries have some type of consumption tax, this does not necessarily mean that these taxes are covered by the OECD Guidelines, which apply only to VAT systems that have certain basic features.[106] Therefore, having the name "VAT" alone does not actually mean that a national tax is covered by the OECD Guidelines. On the other hand, taxes that show the required basic features but carry a different name, such as the commonly used name goods and services tax, are nevertheless covered by the OECD Guidelines.[107]

The scope of the OECD Guidelines is limited to broad-based non-cumulative multi-stage consumption taxes. It is thus restricted to taxes that are intended to tax final household consumption.[108] As the introduction to this article explained, under a consumption-type VAT, the input VAT on purchases for use in production (ie non-consumption), including purchases of capital goods, is generally recoverable (through the invoice-credit method or subtraction method). Thus, in effect, the tax is

104 Binding dispute resolution mechanisms require the appropriate legal framework. The OECD Guidelines by themselves cannot provide a sufficient framework: see OECD Guidelines, 4.9; for more details and explanations, see T Ecker, "Digital economy international administrative cooperation and exchange of information in the area of VAT", in M Lang and I Lejeune (eds), *VAT/GST in a global digital economy* (Kluwer, 2015), 141, 153 et seq and 158 et seq.

105 A fully developed VAT model convention can be found in Ecker, *A VAT/GST model convention*, above n 3, 3 et seq.

106 See OECD Guidelines, preface para 8 and ch 1.

107 See OECD Guidelines, fn 1 and preface para 8.

108 See, eg, OECD Guidelines, preface para 8, 1.2, 1.5, 1.8, 2.3, 3.1.

in principle not borne by business but only levied on private consumption. This also means that income-type VATs or product-type VATs are not covered by the OECD Guidelines.[109] Turnover taxes, for instance, that do not allow for any kind of deduction of VAT paid on inputs and which therefore are cumulative in nature, are not covered by the OECD Guidelines, even if they are called a "VAT" under their domestic law. Of course this does not mean that turnover taxes do not remain a viable policy option for countries. It just means that the OECD Guidelines do not directly apply to such taxes. Countries with a turnover tax that wish to avoid double and non-taxation (including with VATs in other jurisdictions) may nevertheless find the OECD Guidelines a useful reference point.[110]

The restriction to broad-based taxes means that excise taxes, which are typically targeted at a specific form of consumption (eg alcohol, tobacco, gasoline) are not covered.[111] Single-stage sales taxes, such as those operated at state and local level in the US and parts of Canada, are also not covered by the OECD Guidelines.[112]

Furthermore, the OECD Guidelines only concern transactions in an international context. Mere domestic transactions by domestic businesses are therefore outside the scope of the guidelines.[113] In any case, it is important to note that the OECD Guidelines do not give any express recommendations on basic VAT design features, such as tax rates, exemptions, whether a VAT system should distinguish between B2B and B2C transactions, or the method by which business should be relieved from the tax burden (eg input tax credit/refund, zero rating of inputs).

Finally, the OECD Guidelines focus on supplies of services and intangibles.[114] Thus, for instance, guideline 3.1 (and consequently all other place of taxation guidelines implementing this guideline) explicitly refers to "internationally traded services

109 Very few, if any, countries continue to explicitly levy income- or product-type VATs: see, eg, James, *The rise of the value-added tax*, above n 3, 98–99. For further details on these methods, see H Zee, "Value-added tax", in Shome (ed), *Tax policy handbook*, above n 8, 86, 86; Terra and Kajus, *A guide to the European VAT directives*, above n 10, 288 et seq; Ecker, *A VAT/GST model convention*, above n 3, 93 et seq.

110 Thus, if Kazakhstan succeeds in converting its existing VAT to a turnover tax, the new tax would technically not be within the scope of the OECD Guidelines, although the guidelines might still be relevant: see above, n 65.

111 See OECD Guidelines, 1.3.

112 See OECD Guidelines, preface para 8 and ch 1, para 1.5.

113 Admittedly, however, one would need to refer to the OECD Guidelines in order to establish whether a transaction is a "domestic transaction". For instance, a sale of immovable property situated in country A between two businesses established in country B would — according to the guidelines — be a transaction in an international context from the point of view of country B (see guideline 3.8, which would put the place of taxation in country A).

114 See OECD Guidelines, preface para 5 and especially the place of taxation guidelines.

and intangibles". Supplies of goods are generally not covered.[115] Nevertheless, the neutrality guidelines (see section 4.2 below), and to some extent the supporting measures (see section 4.4), seem equally fit to be applied to goods.

As part of the process for assessing the relevance of the OECD Guidelines, non-OECD countries (as well as OECD countries) would be well advised to analyse whether their "VAT" actually falls within the scope of the guidelines. Strictly speaking, the recommendation only extends to taxes covered by its scope, but useful insights could still be gained from the guidelines for other turnover or consumption taxes.

4.2 Neutrality guidelines

The neutrality norm, that is, the idea that tax instruments work best when they interfere least with production and consumption decisions in a properly functioning market, could be considered as the organising principle or the underlying value that informs the OECD Guidelines as well as the idea of the "good VAT" in general.[116] In assessing the relevance rather than the suitability or achievability of the guidelines, this article does not address the prior considerations that relate to the desirability of neutrality as a normative principle of taxation because this is so heavily tied to the debate on the normative merits of taxing consumption over alternatives such as income.[117] In keeping with the focus of the OECD Guidelines themselves, this article also does not address domestic aspects of neutrality, such as the setting of tax rates and exemptions.

Chapter 2 contains the guidelines on VAT neutrality. Guidelines 2.1 to 2.3 set out the basic neutrality principles that reflect the design features of VATs covered by the

115 The inclusion of rules for cross-border supplies of goods in the OECD Guidelines is, however, a (long-term) goal; see, eg, the statement of outcomes of the Third Meeting of the OECD Global Forum on VAT (see above n 3) where the delegations urged the OECD to undertake further work in this respect. Work on the importation of low value goods has been undertaken as part of BEPS Action 1: OECD/G20, BEPS action 1: addressing the tax challenges of the digital economy, above n 3, 82 et seq, and annex C (181 et seq).

116 See, eg, James, *The rise of the value-added tax*, above n 3, 26–28; Ebrill et al, *The modern VAT*, above n 15, 17; International Tax Dialogue, "The value added tax: experience and issues", above n 67, 7; Terra and Kajus, *A guide to the European VAT directives*, above n 10, 7.3.1.3; van Brederode, *Systems of general sales taxation*, above n 39, 46; Ecker, *A VAT/GST model convention*, above n 3, 103ff.

117 For opposing views on the suitability or achievability of neutrality as the pre-eminent norm in tax policy see, eg, L Murphy and T Nagel, *The myth of ownership: taxes and justice* (Oxford University Press, 2002); Secretariat – United Nations Conference on Trade and Development, *Trade and development report, 2012* (UNCTAD/TDR/2012) (2012), 118. A relevant critique for non-OECD countries is Stiglitz's critique of the claim that neutrality necessarily facilitates growth because it is based on the dubious assumption of perfect markets and ignores the corrective role of taxation in addressing market failures: J Stiglitz, "Development-oriented tax policy", in R Gordon (ed), *Taxation in developing countries: six case studies and policy implications* (Columbia University Press, 2010), 11, 14.

guidelines, while guidelines 2.4 to 2.6 are concerned with neutrality specifically in international trade.

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". This guideline reflects one of the design features of VATs covered by the guidelines. It also recognises that jurisdictions may explicitly legislate rules that place a VAT burden on businesses (eg through exemptions without the right for input VAT deductions). However, in such a case, the OECD Guidelines urge that this be done in a fair, reliable, transparent and non-discriminatory way.[118]

Adherence to the neutrality principle within a domestic setting may be less of an issue due to the fact that businesses that make domestic supplies usually have taxed output supplies against which the VAT on input supplies can be offset. However, the situation may pose more of a challenge with respect to businesses that mainly supply abroad (ie export goods or services). If the traditional invoice-credit method is applied to prevent a VAT burden for such a business, the latter will often be in a refund position. This generates risks for tax administrations, especially if they lack adequate supervision capacities. If, on the other hand, the VAT burden is prevented by zero-rating supplies to such businesses, there may be a risk that goods are fraudulently zero-rated and end up in the hands of consumers without having been taxed and the refund position may just occur a stage earlier in the business chain. A similar issue arises if a reverse charge is applied.[119] In all these scenarios, the extent of the issue will largely depend on the supervision capacity of a country's tax administration.[120] As mentioned before, countries that are susceptible to these issues because of their limited administrative capacity should consider the policy options available to them in light of this capacity. The case of Kazakhstan is a clear example of these administrative pressures resulting in a potential change of policy (in this case, moving from a consumption VAT (in theory if not in practice) to a cumulative turnover tax where the tax burden is specifically designed to fall on business).[121] Such a tax would, however, not represent a VAT as covered by the scope of the OECD Guidelines.

Guideline 2.2 states that "[b]usinesses in similar situations carrying out similar transactions should be subject to similar levels of taxation". Guideline 2.3 states that

118 The second norm of good VAT design attempts to achieve this neutrality towards business at a domestic level. For more on how the OECD cautions against departures from this neutral approach see eg OECD Guidelines, 2.3 et seq, 2.26 and 2.32 et seq.

119 See section 4.3.1 below for a further discussion of the reverse charge mechanism and the risks that it entails.

120 For a discussion of the different approaches with respect to the extractives industry, see van Oordt, Stern and Okoh, "Guidance note on value-added tax in the extractive industries", above n 3.

121 See above n 65. Of course, depending on market conditions, the cumulative turnover tax might in the end be fully or partly shifted to the final consumer.

"VAT rules should be framed in such a way that they are not the primary influence on business decisions".[122] Again, these are general design principles that policymakers are probably well advised to consider. The "level of taxation" referred to in guideline 2.2 means the final tax burden, taking into account all exemptions, credits and refunds.[123] For example, it would be contrary to guideline 2.2 for an input taxed business to suffer double taxation because it incurs irrecoverable VAT twice on the same input (eg because it is acquired abroad and both jurisdictions tax while denying a refund) while a business in a similar situation incurs irrecoverable VAT on the same input in only one jurisdiction (eg because it acquires the input locally).[124] Adherence to the place of taxation rules in chapter 3 of the guidelines should, however, help prevent such situations.

Guideline 2.4 establishes a kind of non-discrimination principle. According to this guideline, "[w]ith respect to the level of taxation, foreign businesses should not be disadvantaged or advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid". Thus, VAT should not distort competition and should neither deter investment nor serve as a means of attracting investment. The destination principle is an important means to reach this result because by taxing all goods and services consumed in a given jurisdiction equally, regardless of where they have been produced, it is neutral as between domestic and overseas suppliers/domestic supplies and imports.[125]

Guideline 2.5 is closely connected to the non-discrimination principle in guideline 2.4. It provides that "to ensure foreign businesses do not incur irrecoverable VAT, jurisdictions may choose from a number of approaches". Possible approaches include a refund system (either with or without registration), zero-rating or purchase exemption certificates.[126] The choice of approach will likely depend on the capacity of the tax administration and the potential risks involved. In any case, the fact that there are different measures that lead to the same result should also be considered if countries require reciprocity for VAT relief. While the residence country of the business may not apply the same method, it may nevertheless grant relief through another approach.[127]

Guideline 2.6 takes account of the additional complexity of cross-border transactions and the increased risks involved by recognising that specific administrative

122 This is probably the most important neutrality principle as it more or less includes all the others. See further Ecker, *A VAT/GST model convention*, above n 3, 103 et seq.

123 See OECD Guidelines, 2.40.

124 See OECD Guidelines, 2.40.

125 OECD Guidelines, 2.32, 2.33, 3.1. The third norm of good VAT design reflects this aspect of neutrality.

126 See OECD Guidelines, 2.15 and 2.56 et seq; for further policy options that, however, may not all entirely fulfil the neutrality guidelines, see van Oordt, Stern and Okoh, "Guidance note on value-added tax in the extractive industries", above n 3.

127 See OECD Guidelines, 2.27 et seq.

requirements for foreign business may be necessary. In such a case, however, these specific requirements "should not create a disproportionate or inappropriate compliance burden for the business". This means that the specific requirements should not result in a disguised form of discrimination (which would be in conflict with guideline 2.5) and should not, for example, lead to the result that input VAT that is legally recoverable becomes factually or practically not recoverable because of formal or other requirements.[128]

A continuing theme that emerges from the discussion of these neutrality principles is that even if a jurisdiction chooses to adopt the OECD Guidelines, the ability to give effect to them is governed by the capacity of that jurisdiction's tax administration. The often limited administrative capacity of revenue administrations in non-OECD countries is therefore an important factor to take into account in assessing their relevance and ultimately their suitability and achievability.

4.3 Place of taxation guidelines

While simple in theory, the destination principle has proven difficult to achieve in practice and especially so with the rise of a suite of non-traditional services and intangibles that do not respect the border controls traditionally required to refund VAT on exports and impose VAT on imports. The OECD Guidelines offer an answer to a problem which presupposes this issue, which is how to rectify a lack of coordination among different jurisdictional approaches to the place of taxation rules for services and intangibles. However, in doing so, the guidelines necessarily engage with the technical and theoretical issues that concern the best way to tax these problematic supplies across borders. Guideline 3.1 clearly aims to achieve the destination principle when it states that "[f]or consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of *consumption*".[129]

The OECD Guidelines comprise a mixture of principle and pragmatism in attempting to develop a set of place of taxation rules that both give effect to the destination principle and are workable at an international level. For example, in a world of perfect cooperation among jurisdictions, one might adopt a very different set of rules. If it was possible to achieve harmonisation on VAT bases and rates as well as cooperation on collection, the system might simply entail a statement of the destination principle, a directive for a central administration to collect taxes, or for

128 See OECD Guidelines, 2.19 et seq and 2.60 et seq. Examples that would be problematic include: a de minimis threshold for input VAT recovery that is too high; the requirement of a disproportionately high bank guarantee; the requirement of inappropriate and unnecessary documentation; an inappropriately lengthy time taken to provide a refund; or, if the business compliance costs connected with the recovery of input VAT would be higher than the VAT at stake.

129 OECD Guidelines, 3.1 (emphasis added).

national tax administrations to collect all taxes from suppliers over whom they have jurisdiction and then a method to distribute revenue (through a clearing mechanism or predetermined formula reflecting consumption shares etc).[130] However, the OECD Guidelines are designed for the real world of imperfect cooperation and coordination for which such options are currently unachievable between nation states.[131]

This section of the article analyses the various rules necessary to give effect to the destination principle, which include: (1) the rules relating to the appropriate treatment of B2B supplies (so that the VAT can be appropriately accounted for at all stages of the business chain when the chain involves cross-border transactions) (section 4.3.1); (2) the rules relating to the treatment of B2C supplies (so that final consumption is taxed (and in this context by the right jurisdiction)) (section 4.3.2); and (3) exceptions to the general rules (so that departures from the general rules are possible but confined) (section 4.3.3). The analysis in this section highlights some general issues with the rules with a specific focus on issues that might prove particularly challenging for non-OECD countries.

4.3.1 B2B supplies

The ultimate goal of the VAT is to tax B2C supplies; however, it is necessary to have consistent place of taxation rules in place for B2B supplies in order to effectively collect VAT on all stages of the business chain (to support the staged collection process). The OECD Guidelines contain three rules relevant to the treatment of B2B supplies. The primary rule at 3.2 states that for the purposes of determining the place of taxation for B2B supplies, "the jurisdiction in which the *customer* is *located* has the taxing rights over internationally traded services or intangibles".[132] The guidelines explain that customer location is considered an appropriate proxy for business use because, by and large, when a business buys in services or intangibles from another jurisdiction, it does so for the purposes of its business operations in that jurisdiction.[133] From a practical point of view, taxing B2B supplies where the customer is located is also the easiest approach to administer (especially if combined with the reverse charge

130 Such systems can be achieved at a national level in federal jurisdictions — for example, in Australia and Austria, the federal government imposes and collects VAT on all transactions across all states and territories and distributes revenue to states according to a fiscal equalisation formula (in Austria, a significant portion is retained by the federal government); in Canada, the federal government collects VAT and distributes to provinces according to a consumption-based formula.

131 A sign of the political infeasibility of a centralised collection and distribution approach among nation states is that within the EU — perhaps the most harmonised and integrated regional grouping that exists — such a system had for very many years been the long-term goal, but has recently been dismissed as not achievable: see European Commission, Green paper on the future of VAT, 1.12.2010, COM(2010) 695 final, 6 et seq).

132 OECD Guidelines, 3.2.

133 OECD Guidelines, 3.9.

mechanism), because it prevents cross-border refunds which are difficult and risky to administer for tax administrations and cause compliance costs for businesses.[134]

The need to distinguish between B2B and B2C supplies in the OECD Guidelines primarily results from a combination of the choice to tax on the basis of customer location together with the preference for the reverse charge mechanism as the best method currently available to do so for B2B supplies. However, because the reverse charge method is not considered viable for B2C supplies, the OECD Guidelines recommend it only for B2B supplies (see step 4 below). This demonstrates the pragmatic compromises foreshadowed in section 1 — in order to have a workable collection method for cross-border B2B supplies (to support the VAT's staged collection mechanism), a departure from the standard "good" VAT is introduced which warrants the need to distinguish B2B from B2C supplies. However, there might be additional reasons why it might be necessary, or at least justifiable, to distinguish B2B and B2C supplies.[135]

Although the OECD Guidelines do not expressly direct it, the place of taxation rules for B2B supplies under the guidelines essentially entail a four-step approach to determine customer location. The first three steps are directed at establishing the customer's location and therefore the place of taxation, and the fourth step is directed at establishing who is liable to remit the VAT to the place of taxation. The first step requires determining who the customer (and the supplier) is. The second step requires a determination of whether or not the customer is a business. The third requires the location of the customer to be determined. If the customer has a single location, then step 4 applies. If the customer has multiple locations, the guidelines require an additional determination (step 3(a)), of which of these locations is the decisive one for the purposes of establishing the place of taxation. Once the place of taxation is determined, step 4 requires a determination of who is liable to remit the VAT to that jurisdiction.

Steps 1 and 2 – determining the customer identity and business status. In order to determine the customer location, it is first necessary to determine who the customer is. Guideline 3.3 offers further guidance by providing that "the *identity* of the *customer* is normally determined by reference to the *business agreement*" in force at the time

134 From a neutrality perspective, a customer location rule clearly shows advantages over a supplier location rule as the level of taxation is independent of the location of supplier and thus leads to competitive neutrality in the market where the service is used. Again, this is for the most part only relevant where there is no (full) right for input VAT deduction. For a more detailed evaluation, see Ecker, *A VAT/GST model convention*, above n 3, 338ff. In developing the guidelines, the OECD also considered that there may be businesses that cannot recover input VAT (eg often in the financial sector) and since it is more likely that the customer (as compared to the supplier) is located in the jurisdiction where the supply to the final consumer will take place, this seems to be the better place to tax such supplies and thus the better attribution rule for VAT revenue.

135 For an extensive analysis of different place of taxation rules and reasons that may have led some policymakers decide to distinguish between B2B and B2C supplies, see Ecker, *A VAT/GST model convention*, above n 3, 143ff, 274ff, 338ff, and 363ff.

of the supply.[136] This concerns the question of who the customer is and whether the customer is a business (for jurisdictions that draw this distinction).[137]

"Business agreement" is intended as a general, rather than technical, term and so is broadly defined to "consist of the elements that *identify* the parties to a supply and the rights and obligations with respect to that supply".[138] A business agreement may or may not constitute a contract, may or may not be in writing and might also include other relevant components that evidence the "mutual understanding" of the parties, such as general correspondence, purchase orders, invoices, payment instruments and receipts.[139] The broad definition of business agreement, which incorporates more than just the elements provided by the parties to the supply but all known elements that demonstrate the underlying economic reality of the transaction, is presumably designed to try to ensure that, as far as possible, the term captures the real economic substance of transactions. Although companies might still attempt to characterise their business structures in a way designed to optimise VAT consequences, the broad definition of business agreement which incorporates the wider economic context might limit their scope to do so. So if, for example, it is clear from the circumstances of a case that it was always the intention that A Co should supply to C Co, it does not matter whether B Co (from a legal point of view) orders the supply or that B Co pays for the supply.

Once the supplier knows who the customer is, they will next have to determine if the customer is a business (if the destination country draws this distinction).[140] The OECD Guidelines imply that the business agreement should be a sufficient basis for the supplier to identify the business status of the customer (ie their status as a

136 OECD Guidelines, 3.3 (emphasis added).

137 Many non-OECD countries do not distinguish between B2B and B2C supplies: see the discussion under step 4 below.

138 OECD Guidelines, box 3.1 (emphasis added).

139 OECD Guidelines, 3.16. Elsewhere (at 3.44) the guidelines justify the reliance on the term "business agreement" by explaining that "in a business to business environment it is reasonable to assume that suppliers will normally have developed a relationship with their customers" which is especially the case with ongoing supplies or with a supply so valuable that it warrants a business agreement being entered into. Perhaps because of this explanation, Lamensch criticises the reliance on a business agreement on the basis that there may not always be a relevant business agreement supporting a B2B supply as might be the case with a digital supply made to an occasional customer: M Lamensch, "The OECD international VAT/GST guidelines: completion of a (first) major step towards global coordination of value-added-tax systems" (2016) 44(5) *Intertax* 360 at 364. However, this criticism seems to place too high a threshold on what is necessary to constitute a business agreement, which equates it more to a legal contract. A one-off transaction based on a purchase from a website where an order is placed, money is paid, where the customer may enter a VAT identification number and where the service paid for is received would all be sufficient, or establish sufficient information for the purpose of the place of taxation rules, to constitute a business agreement.

140 See the discussion below at step 4.

business rather than a final consumer). For the definition of "business", the guidelines refer to whether persons and entities, or certain of their activities, are recognised as "business" in national law. This may concern either recognition for VAT purposes specifically or in national law more generally (notably in jurisdictions that have not implemented a VAT).[141] This carries risks for disparities to emerge which again may lead to double or non-taxation.[142] Further work on the OECD Guidelines will likely be needed in this respect.

Step 3 – determining the location(s) of the customer. Having established the identity of the customer and that they are a business, the supplier needs to determine the location of the customer. The OECD Guidelines explain that the relevant location is "the jurisdiction where the customer has located its *permanent business presence*".[143] No further clarification of the notion of permanent business presence is offered. However, the wording of the explanation to guideline 3.2,[144] as well as its purpose to function as a general rule for the place of taxation, suggests that *every* business no matter how large or small must have a permanent business presence. It therefore seems that the term "permanent business presence" is wider in scope than the term "establishment" used in guideline 3.4. One reason for this could be that there may be cases where a business has no establishment in any country (eg because the taxable person runs their business over the internet from their home). In such a case, because non-taxation cannot be the aim of the OECD Guidelines, one could argue that reference may be made to the place of usual residence for the determination of the customer's permanent business presence.

There clearly remains some work to do on the scope of the term "permanent business presence"; for example, what establishes "permanence" or a recognisable "business presence" in this context, as well as what distinguishes the threshold requirements of "permanent business presence" and "establishment" (discussed at step 3(a)). These questions are relevant to determining steps 2, 3 and 3(a). To reduce disparities and increase certainty, further guidance will be needed in the future.

141 OECD Guidelines, fn 23, 3.7.

142 For a critical assessment of the potential reasons and consequences, see the similar discussion on the notions of "permanent business presence" and "establishment" in the subsequent steps 3 and 3a.

143 OECD Guidelines, 3.9.

144 OECD Guidelines, 3.9, where reference is made to "where the customer has located its permanent business presence", which suggests that every business has a permanent business presence.

Once the business customer is identified, the guidelines recognise that legal entities[145] may either have just one establishment ("single location entity" (SLE))[146] or multiple establishments ("multiple location entity" (MLE)). If a customer has establishments in more than one jurisdiction, guideline 3.4 provides that "the taxing rights accrue to the jurisdiction(s) where the establishment(s) *using* the service or intangible is (are) located". [147]

Step 3(a) – determining the relevant location for a multiple location entity. In contrast to the term "permanent business presence", the OECD Guidelines concretise the "establishment" concept to some extent by providing that:[148]

> [I]t 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.

The OECD Guidelines further state that mere registration in a jurisdiction for VAT purposes does not by itself suffice to constitute an establishment. It is implied from the guidelines that an establishment will always have a permanent business presence but the concept of establishment seems to entail more than just a permanent business presence. Given that a jurisdiction can only be allocated the right to tax under the general rule for B2B supplies to MLEs if the customer has an establishment there, the establishment concept performs a crucial role for the determination of the place of taxation for these supplies of services and intangibles. As is the case with the domestic laws of many jurisdictions, the "establishment" concept serves as a kind of threshold for

145 "Legal entity" is defined to include natural persons, non-commercial institutions such as governments and not for profits, provided that their activities are recognised as "business" under the relevant domestic law in which they operate. This might include their status as a registered entity under the VAT or under another national law (in jurisdictions without a VAT): OECD Guidelines, fn 23.

146 In the context of a supply to an SLE, the guidelines state that the legal entities involved as supplier and purchaser need to be located solely in their respective (and separate) jurisdictions and *have no business presence elsewhere.* However, having common ownership, management or control does not prevent them from being SLEs: OECD Guidelines, 3.41, 3.48. Likewise, the determination of the place of taxation for a supply to an SLE is not affected by: (i) an onward supply to a third party; (ii) the direct supply of the service or intangible to a third party that is not the customer under the business agreement; or (iii) payment by a third party who is not the customer under the business agreement. These caveats are designed to accommodate the business practices of multinational businesses where it is common for a central procurement company to leverage economies of scale by purchasing items for the multinational group and then distributing those inputs to related entities worldwide: OECD Guidelines, 3.49, 3.50–3.70.

147 OECD Guidelines, 3.4 (emphasis added).

148 OECD Guidelines, fn 24.

the attribution of taxing rights to a certain jurisdiction.[149] The underlying reasoning must be that only if the presence in a jurisdiction exceeds this threshold does taxation in that jurisdiction lead to a better result than taxation in another jurisdiction. Relevant to this assessment is the accuracy of the place of taxation rule as a proxy for consumption, as well as the broader normative considerations listed elsewhere in the OECD Guidelines of: neutrality; efficiency of compliance and administration; certainty and simplicity; and effectiveness and fairness.[150]

Despite the importance of the "establishment" concept, the OECD Guidelines do not offer much further guidance on its content. Similar to the concept of "permanent business presence", the political sensitivities and the complexities connected with such a definition[151] may have led the OECD to set this issue aside for the moment. Currently, it is left to individual countries to decide how they define these key terms under their domestic VAT legislation.[152] In practice, much will turn on how the customer's jurisdiction defines these terms. In some respects, this is in keeping with the purpose of the OECD Guidelines which seek to provide broad parameters with individual countries left to fill in the detail through implementation. However, the reliance on domestic laws to clarify these matters leaves open the possibility that confusion and inconsistent approaches might arise leading to potential double or non-taxation.[153] Given the important role of these key terms and the uncertainty over their scope, the further development of these concepts should become at least a medium to long term component of the future work on the guidelines to ensure consistency in country approaches.

Having determined that the customer is an MLE, the task is then to determine which establishment uses the service or intangible. Guideline 3.4 deliberately contains

149 See, eg, the Member states of the European Union (arts 44 and 45, EU VAT Directive (2006/112/EC)); Switzerland (art 8(1), Swiss VAT code); Australia (*A New Tax System (Goods and Services Tax) Act 1999* (Cth) — see the role of "enterprise" for the relevant provisions establishing taxation of offshore supplies of services and intangibles — ss 9-20, 9-25(1)-(5), 84-5(1)(c) and 85-5(2)); New Zealand, *Goods and Services Tax Act 1985*, s 8B, definition of "resident", s 2(1).

150 See section 4.3.3 below for more details on these criteria and their use; for a more detailed evaluation, see also Ecker, *A VAT/GST model convention*, above n 3, 153 et seq and 353 et seq.

151 Experience with the concept of establishment in other areas of tax law (like the "permanent establishment" concept for income taxes) demonstrates that it is politically very difficult to arrive at a common definition of establishment and that even if one is reached, the question of what constitutes an establishment may contain quite some complexity and still give rise to disparities. For instance, if two jurisdictions apply this concept differently, this may again lead to double or unintended non-taxation.

152 OECD Guidelines, fn 24.

153 The following example illustrates the issue. Business A (in state A) provides services to a potential establishment in state B of business C (head office in state C). If state B considers that there is an establishment in state B, while state C thinks there is not, double taxation would arise. In the converse case, non-taxation would result. See further Lamensch, "The OECD international VAT/GST guidelines", above n 139 at 364.

the term "use" to distinguish B2B supplies from B2C supplies which result in final consumption.[154] "Use" is broadly defined (albeit in a circular manner) to include use that is "immediate, continuous, directly linked to an output transaction or supports the business operations in general".[155] The OECD Guidelines then note three possible approaches currently adopted by jurisdictions to "identify which customer's establishment is regarded as using a service or intangible and where this establishment is located".[156] These include: (1) the direct use approach — defined in a somewhat circular way as focusing directly on the establishment that *uses* the service;[157] (2) the direct delivery approach which focuses on the establishment that takes *delivery* of the service or intangible;[158] and (3) the recharge method which focuses on the establishment that uses the service or intangible as determined by the internal recharge arrangements within the MLE made in accordance with corporate tax, accounting or other regulatory requirements.[159] Although each approach seeks to achieve the same goal — to tax in the jurisdiction where the establishment that actually *uses* the service or intangible is located — the approaches adopt different ways to get there and might, in certain cases, lead to different results. Likewise, each approach has its own strengths and weaknesses. In failing to more fully engage in the respective merits of each approach, the OECD Guidelines might be criticised for leaving open a number of important questions.

The direct use approach, generally used in the EU,[160] is conceptually straightforward and effective where there is obvious use by the establishment of the customer MLE, but less so where the use is harder to detect — and therefore requires a large amount of information for the supplier. In many cases, domestic legislation implementing the OECD Guidelines might seek to provide safeguards to ease the compliance burden for well-meaning suppliers who are diligent in obtaining relevant information but ultimately get the answer wrong.[161]

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154 OECD Guidelines, 3.5, 3.6. Footnote 25 therein states that the term "use" differs from the concept of "use and enjoyment" existing in some national laws which can refer to actual use by a customer in a jurisdiction irrespective of the presence of any customer establishment.

155 OECD Guidelines, 3.24.

156 OECD Guidelines, 3.25.

157 OECD Guidelines, B.3.1; 3.71.

158 OECD Guidelines, B.3.2; 3.71.

159 OECD Guidelines, B.3.3; 3.71.

160 Art 44, EU VAT Directive (2006/112/EC) provides that for services provided to a fixed establishment of the taxable person located in a place other than the place where that person has established his or her business, the place of supply of those services shall be the place where that fixed establishment is located.

161 For an example of this approach in a slightly different context, see the Australian provisions implementing the OECD Guidelines for B2C supplies, which essentially deem an otherwise taxable supply to be not taxable if a supplier has taken reasonable steps to obtain information which leads to a reasonable belief that the purchaser is not an "Australian consumer" as is required for the transaction to be taxable (even if this belief was mistaken): s 84-100(1). If VAT registration is the relevant information relied on by the supplier, then a belief is only reasonable

The direct delivery method is an easy solution in situations where the use of a service or intangible is likely to occur in the same location as delivery (for example, an on-the-spot supply, such as a catering service), but is obviously less effective when this is not the case. The method is generally not adopted in practice because of the avoidance risk the approach entails (ie where tax obligations might be avoided simply by directing delivery to a non-VAT jurisdiction).[162]

Both the direct use and direct delivery methods only permit use to be attributed to one establishment and so are ineffective at accurately capturing use when more than one establishment in the customer MLE uses the service or intangible.[163] The recharge method, a variation of which is used, for example, in Australia, Canada, New Zealand, South Africa and Switzerland,[164] is an attempt to provide a method of allocating VAT in this situation. The suitability of the recharge method ultimately depends on whether one wants to view internal transactions as supplies — itself a contested issue beyond the scope of this article.[165]

The recharge method is divided into two parts. The first step involves allocating taxing rights to the jurisdiction of the establishment representing the MLE with the supplier. Provided that the supplier can establish the identity of the purchaser (ie that their location is outside their jurisdiction and that they are a business) then a VAT-free supply is made. The customer establishment representing the MLE applies the reverse charge mechanism. This is the end of the matter from the supplier's perspective.[166] Unlike the direct use method, the recharge method is relatively straightforward from the supplier's perspective.

The second step applies where the service or intangible is used wholly or partially by more than one establishment within the MLE. In this case, taxing rights follow the internal recharge arrangements made by the customer MLE to the various

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if the relevant VAT identification number (Australian business number) is provided together with a declaration by the customer that they are a registered VAT entity: s 84-100(3) of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

162 To the authors' knowledge, no jurisdiction uses the direct delivery approach. See OECD Guidelines, B.3.2; Lamensch, "The OECD international VAT/GST guidelines", above n 139 at 365.

163 OECD Guidelines, B.3.1.

164 See, eg, Australia (*A New Tax System (Goods and Services Tax) Act 1999*, s 11-15(3) and Div 84 — ss 84-5, 84-15, 84-20, 84-25), Canada (see *Excise Tax Act*, Pt IX, ss 123(1), 132, 217 and 220), New Zealand (*Goods and Services Tax Act 1985*, s 56), South Africa (*Value-Added Tax Act 1991*, ss 1, 8(9), 11(1)(i) and 11(2)(o)), and Switzerland (see MwSt-Info by the Eidgenössische Steuerverwaltung, 02, 1.2); for a more detailed overview, see T Ecker, M Lang and I Lejeune (eds), *The future of indirect taxation: recent trends in VAT and GST systems around the world – a global comparison* (Kluwer, 2012), 39ff, 119ff, 372ff, 466, 489ff.

165 For an overview of the issues, see eg A Charlet and D Koulouri, "Relations between head offices and permanent establishments: VAT/GST v direct taxation: the two faces of Janus", in Lang, Melz, Kristoffersson (eds) and T Ecker (ass ed), *Value added tax and direct taxation*, above n 10, 703.

166 OECD Guidelines, 3.83.

establishments that use the service or intangible. In a straightforward case, such as the purchase of IT services to support a new computer system upgrade for one establishment of the MLE, use and therefore the apportionment of the "charge" might be easy to directly identify. However, the OECD Guidelines recognise that this might not be the case where a service or intangible is used across an MLE and it is difficult to isolate use on an establishment by establishment basis, such as legal or marketing services where the benefits are diffusely shared. In this case, the OECD Guidelines permit the use of cost allocation or apportionment methods (allocation keys) that should result in a "fair and reasonable" allocation of use/charges[167] which reasonably reflect the actual use of the service or intangible, follow sound accounting principles and contain safeguards against manipulation.[168] Common allocation keys might include: the number of employees, square metres of office space, number of fleet cars, computer usage, advertising expenses, number of accounting entries and the number of invoices processed. Alternatively, where these allocation keys still cannot produce accurate results, recharging might simply occur according to the size of the establishments concerned.[169]

The OECD Guidelines acknowledge the complexity of the recharge method and the risks it entails when they state that it is important for the proper operation of the method that the relationship between the initial supply of the service or intangible to the MLE (ie the first step) and the onward recharges(s) of use (ie, the second step) not become obscured.[170] This complexity and risk is captured by the suggestion that tax administrations will need an audit trail that enables them to review commercial documentation down to a transactional level in order to accurately determine the nature of the individual service that is recharged and thus to determine that the place of taxation, taxable amount and applicable rate of VAT are correct.[171]

A further issue with respect to the application of the recharge method is that the OECD Guidelines only deal with externally acquired services that are then passed on. They currently do not deal with the complex question of how to value inter-company transactions.[172] This is a crucial question, especially when it comes to businesses that are (partially) input taxed, ie, exempt without the right for deduction of input VAT. There are, for example, at least three competing methods to value these internal supplies each entailing different strengths and risks. The first might not tax the value

167 OECD Guidelines, 3.93.

168 OECD Guidelines, 3.93.

169 OECD Guidelines, 3.94.

170 OECD Guidelines, 3.95.

171 OECD Guidelines, 3.104. Relevant documents include the original invoice, allocation method and allocation keys and evidence of calculations of VAT liability and accounting entries: ibid, 3.105.

172 For example, a supply wholly self-created by one establishment and supplied cross-border to another establishment or cases where an establishment transforms input into a new output with increased value which it supplies cross-border to another establishment of the same business.

added on internal transactions at all because if such transactions are not viewed as supplies if they occur in a mere domestic context, then this position should not change simply because the internal service is acquired in another jurisdiction.[173] The second method might tax the value added of internal transactions on a cost basis[174] so that the tax burden in the country of the establishment using the service does not depend on whether the inputs needed for the value creation were acquired abroad or domestically. In this case, all inputs would, in the end, be taxed in the country that the exempt services are supplied from. The third method might tax the internal transaction at an arm's length price, thus putting the recharge on par with comparable externally acquired services. In this case, the whole value of the internally acquired supply would be taxed in the country that the services — for which the internal supplies serve as input — are supplied from. All approaches may leave room for different and probably unintended tax planning opportunities. The OECD Guidelines currently leave this issue completely open and thus might be criticised for presenting half of the picture.

It is not necessary to delve into all the complexities of the recharge method, to make the point that such an approach — like the others — clearly poses significant challenges to tax administrations, especially those with limited administrative and audit capacities and weak records of taxpayer compliance.[175] Furthermore, Valderrama highlights feedback received from Lesotho and Zambia to the United Nations on issues around BEPS implementation which identified problems, such as poor disclosure by the relevant establishment representing the multinational corporate group to the local revenue authority, which would further hamper the effective implementation of the recharge method.[176]

The OECD Guidelines themselves make no judgment as to which is the preferred approach between the direct use, direct delivery and recharge methods, but simply state that whatever approach is adopted should achieve a sound balance between the interests of business (both suppliers and customers, ie keeping compliance costs low) and tax administrations (ie resulting in appropriate revenue and minimising administrative costs).[177] Given that each approach could permit a different answer to the question of where is the place of taxation,[178] this provides scope for conflicting

173 The consequence would be that part of the revenue connected to the exempt output supply of the business would not be taxed in the country where the establishment rendering this output service is located, but part of it would be taxed in the country where the value was added (if that country considers the output supply also as exempt — otherwise part of the output supply would go completely untaxed if the country where the value was added allows input VAT deduction).

174 One could further limit this to costs on which VAT was originally paid.

175 The OECD Guidelines themselves acknowledge that there are a number of "potentially complex" aspects of this method: 3.36.

176 Valderrama, "The OECD-BEPS measures to deal with aggressive tax planning in South America and Sub-Saharan Africa", above n 48 at 619.

177 OECD Guidelines, 3.39.

178 As well as the taxable amount and the relevant VAT rate.

approaches and potentially double or non-taxation.[179] So, for example, A Co (state A) orders legal services from S Co (state S) for its establishment in state B. Under the direct use method, the place of taxation of the supply by S would be state B. Under the recharge method, it would be state A (and only the place of taxation of the subsequent recharge would be in state B). If the supply is physically rendered in the head office in state A (eg the legal advice for the establishment in state B is given in the premises of the head office), then the place of taxation under the direct delivery method would be state A.

From the supplier's perspective, the supplier will need to check where the business customer has their *permanent business presence* (if the customer is a single location entity) or if the customer is a multi-location entity where the establishment that uses (direct use) or orders (recharge) the supply is located or to which establishment the service is delivered (direct delivery). If the direct delivery method is applied, the place of taxation should be the same irrespective of whether the customer is a SLE or MLE. If the customer is an MLE based in a jurisdiction that applies the recharge method or direct use method, the place of taxation might differ.

The response of the OECD Guidelines to this risk is the general plea that "the more jurisdictions adopt the same approach, the greater the reduction in complexity, uncertainty and risks of double taxation and unintended non-taxation".[180] However, it is likely that further work will be required on refining the preferred approach for supplies to MLEs as well as the significant administrative work needed to implement that approach if the required degree of consistency sought by the OECD Guidelines has any chance of being realised by most non-OECD countries

Step 4 – who remits the tax? Irrespective of whether the supply is made to an SLE or MLE, some common elements are present. Provided that the supplier can establish that the supply is made to a business customer located in another country, then the supply should be VAT-free[181] in the "exporting" country. Thus, irrespective of the party from whom the tax is collected, in order to determine the place of taxation, knowledge of all three steps previously mentioned is required.

For taxation of that supply in the other ("importing") country, different collection mechanisms are possible. First, the tax could either be collected from the offshore/non-established supplier as is usually done for B2C services (see section 4.3.2 below).

179 For criticism of the three-pronged approach, see Lamensch, "The OECD international VAT/GST guidelines", above n 139 at 365; the author in that case argues that the recharge method is the only method likely to achieve the correct result for digital supplies for MLEs: at 372, fn 114.

180 OECD Guidelines, 3.40

181 That is, that the exporting state should not levy tax on the output supply but should still grant input VAT relief for the inputs (also often referred to as zero-rating or exemption with the right for deduction).

This usually requires the supplier to register in the "importing" country.[182] Second, the VAT could be collected from the customer (through the reverse charge mechanism). Third, the VAT could be collected from an intermediary.[183]

The preferred collection method recommended by the OECD Guidelines for the "importing" country is the reverse-charge mechanism which, as the guidelines explain, is a "tax mechanism that switches the liability to pay from the supplier to the customer" so that the customer is required to both charge and pay the VAT.[184] If the customer is entitled to full input tax credits in respect of the supply, the local VAT legislation might not require the reverse charge mechanism and simply allow a VAT-free supply. The OECD Guidelines urge the relevant jurisdiction to publicise their approach.[185]

The three most relevant advantages of the reverse charge mechanism which led to it being the preferred VAT collection method firstly include the feature that the tax liability is shifted from a non-established/offshore business to a domestic business, thus providing a more reliable enforcement jurisdiction (ie the relevant taxpayer is located in the jurisdiction with taxing rights).[186] Second, the approach eliminates the risk connected with the supplier collection method that arises from the fact that the tax liability remains with the non-established/offshore supplier but the VAT refund would be given to the domestic business. This mismatch opens a range of potential issues, not least of which is the possibility of missing trader or carousel fraud (that is, the risk that the refund is claimed but the VAT liability is not paid). Third, the reverse charge method is generally preferred by business because it entails less compliance costs because the supplier has no need for precise knowledge of the "importing" country's VAT rules (eg exemptions, taxable base, tax rates) and generally has no need to comply with tax obligations in that country (eg register, file returns, pay taxes, be subject to audits etc). It also avoids the supplier dealing with translation and language barriers and might minimise the need to use fiscal representatives or organise bank guarantees and so forth.[187] The customer, on the other hand, will likely be much better placed to deal with the rules in the jurisdiction where their business is located.

182 For jurisdictions that do not distinguish between B2B and B2B supplies, step 2 is not a necessary requirement.

183 For example, a fiscal representative, a platform over which a supply was made, or financial intermediaries such as banks that are involved in payment processing. The role of intermediaries in remitting VAT on cross-border supplies is an important one and only likely to grow in scope in the future, with jurisdictions such as Australia in effect mostly relying on the collection of VAT from intermediaries for most offshore digital B2C supplies: see further OECD/G20, BEPS action 1: addressing the tax challenges of the digital economy, above n 3, 201ff; *A New Tax System (Goods and Services Tax) Act 1999*, ss 84-55(1), 84-70.

184 OECD Guidelines, fn 26.

185 OECD Guidelines, fn 26.

186 See Hellerstein, "Jurisdiction to tax income and consumption in the new economy: a theoretical and comparative perspective", above n 24 at 1.

187 See also OECD Guidelines, 3.64.

The reverse charge mechanism, however, also contains disadvantages that may be particularly relevant to non-OECD countries, three are mentioned in turn. First, the reverse charge creates the need to distinguish between B2B and B2C supplies which may require a certain level of administrative capacity. The B2B to B2C distinction is well established in the EU member states and at least selectively applied in many non-EU OECD countries.[188] However, a number of non-OECD countries do not distinguish between B2B and B2C supplies.[189] One relevant reason for not doing so is because the country does not have the adequate infrastructure and/or capacity to run a system that supports such a distinction (such as a VAT identification number system for businesses including the necessary databases or categories or lists of services that are considered B2B services). The OECD Guidelines try to accommodate this reality by limiting the recommendation for reverse charge to jurisdictions "'where that is consistent with the overall design of the national consumption tax system".[190] The extensive use of the distinction in Europe has led to the charge that that the OECD rules are Eurocentric.[191] Whether or not this is the case is beyond the scope of this article,[192] for now it suffices to note that although the distinction has its roots in Europe,[193] it is

188 The B2B/B2C distinction is used within the EU and in almost all other European OECD member countries, especially for place of taxation purposes and the application of the reverse charge. Other OECD member countries, including those jurisdictions with "modern" VATs (ie jurisdictions that approximate the good VAT more closely than traditional European VATs) also apply the distinction in specific instances: see, eg Australia (*A New Tax System (Goods and Services Tax) Act 1999* (Cth), Divs 83-84) and New Zealand (*Goods and Services Tax Act 1985,* ss 8(4) and 8(4D). Korea and Japan also apply the distinction: see EY, *2016 worldwide VAT, GST and sales tax guide* (2016). Available at www.ey.com/gl/en/services/tax/worldwide-vat-gst-sales-tax-guide---country-list).

189 See, eg, South Africa, Costa Rica. In these countries, the non-resident supplier generally remains liable for the tax and is required to remit it, usually being obliged to register in the importing jurisdiction.

190 OECD Guidelines, 3.47 and 3.57. As was explained in section 2.2 above, it was input from non-OECD countries on this issue that resulted in the OECD Guidelines not containing a specific rule to apply the reverse charge mechanism for all B2B supplies.

191 See, eg, the comments made as part of a review by the Davis Tax Committee into the South African revenue system: Davis Tax Committee (South Africa), "First interim report on VAT to the Minister of Finance" (December 2014), 87-88.

192 See section 3.2 above for the involvement of non-OECD countries in the OECD Guidelines. For more on this common criticism of VAT policy, see James, *The rise of the value-added tax*, above n 3, chs 2 and 4.

193 The B2B/B2C distinction is long established in the EU and was contained in the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the member states relating to turnover taxes — Common system of value added tax: uniform basis of assessment OJ [1977] L 145/1. The need to employ the distinction arose as a result of the adoption of supplier location as the general place of taxation rule for supplies of services. This would lead to the need for cross-border input VAT refunds for B2B supplies and could result in certain distortions, such as an input-taxed supplier relocating to a low or no VAT jurisdiction to reduce VAT liability. The response was the development of a list of services commonly supplied B2B for which customer location would be the relevant place of taxation rule and the reverse charge was the mechanism

increasingly being employed by non-European jurisdictions both within and outside the OECD as a means of taxing supplies of services and intangibles precisely because it facilitates the effective operation of the reverse charge mechanism.[194] For example, South Africa currently does not apply the reverse charge mechanism based on the fact that they do not distinguish between B2B and B2C transactions, but this decision is currently under review.[195]

The fact that the preferred collection method recommended by the OECD Guidelines is not consistent with the current administrative practice of some non-OECD countries directly draws attention to the need for individual jurisdictions to seriously consider their capacity to implement the OECD Guidelines (as well as the importance of capacity building in this area: see section 4.4 below).[196] This is further emphasised by the second relevant disadvantage of the reverse charge mechanism, which is that it might entail the risk of fraud. For example, there is the risk that customers may misrepresent their status (for example, as registered businesses rather than final consumers) to obtain supplies without VAT charged. Alternatively, customers eligible to reverse charge may try not to report the reverse charge supply because they fraudulently intend not to pay VAT on the subsequent supply. Furthermore, if the reverse charge is not used throughout the whole chain, the refund position may again

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through which these services were taxed. Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services OJ [2008] L 44/11 extended this to nearly all supplies in part to account for the increase of cross-border trade as well as the taxation of new forms of services and digital intangibles. For a more detailed analysis of the benefits and drawbacks of the different proxies, see Ecker, *A VAT/GST model convention*, above n 3, 337ff.

194 See above n 188.

195 The failure to distinguish between B2B/B2C supplies has resulted in certain digital supplies commonly used by business (such as "web site hosting and data warehousing", "subscription to databases" and the supply of software which is a form of "electronic ordering and downloading of digitised products") being excluded from taxation as a way of providing concessions to businesses that incur irrecoverable VAT on such supplies. The Davis Tax Committee recommended maintaining the current approach, subject to monitoring and review as to whether adopting the reverse charge mechanism (and the risks that such an approach entails) is preferable to the maintenance of exclusions (and the risks that such an approach entails). Risks of the current approach include the over-taxation of business, the under-taxation of final consumers and the risk that supplies will be re-characterised to attract concessions: Davis Tax Committee, above n 191, 91-92, 96.

196 Lamensch further criticises the reverse charge mechanism for placing an undue burden on suppliers who must establish whether the customer is a taxable person established abroad (otherwise the supplier should charge VAT). This criticism also relates to the uncertainty around the notion of "establishment": Lamensch, "The OECD international VAT/GST guidelines", above n 139 at 366. However, as was indicated in the above discussion, suppliers often prefer the reverse charge to supplier collection because they do not need to register in the customer's country and they do not require detailed knowledge of the VAT system in that country if the reverse charge applies.

just occur at an earlier stage.[197] This might exacerbate revenue risks in non-OECD countries already experiencing widespread VAT fraud.

The third and related risk of the reverse charge mechanism is that the extensive use of VAT exemptions in many non-OECD countries presents a further barrier to compliance, given that there would be a wide range of potential services and intangibles that might be exempt and for which credits would be denied. This incentivises non-compliance by the recipient of the supply. Although OECD countries with extensive use of exemptions face similar issues, non-OECD countries might not share the same ability to monitor these risks and ensure effective compliance.

Although it is not within the scope of this article to undertake a detailed analysis of all the respective advantages and disadvantages of the different collection mechanisms, it is obvious that both the supplier collection method and reverse charge mechanism carry revenue risks due to different risks of fraud. Technology can help if well implemented (for example, through automated invoice matching systems), but it is also clear that technology alone cannot provide the answer to these risks and can indeed carry its own risks.[198] The effectiveness of both collection mechanisms will ultimately depend on the effectiveness of a jurisdiction's audit capacities to guard against these risks — often a weak point in the tax systems of non-OECD countries.[199] As with many parts of the OECD Guidelines, the choice will be influenced by the administrative capacity of the domestic tax administration.

4.3.2 B2C supplies

As the OECD Guidelines acknowledge, it should theoretically be more straightforward to tax B2C supplies as the objective is simply to tax final consumption in the jurisdiction where it occurs. However, as section 1 indicated, although theoretically appealing, a pure consumption test is impractical in many cases.[200] The purpose of the place of taxation rules is therefore to predict with reasonable accuracy the place where the service or intangible is *likely* to be consumed. The OECD Guidelines recommend an approach that is simple and practical for business to apply, for consumers to

197 See section 4.2 above.

198 In some cases, technology can even increase opportunities for avoidance or evasion. As an IMF report explains, technology can be used to generate very large numbers of fictitious entities and/or claims for input credits that alone are too small to prompt compliance interventions, but in total can result in significant loss of revenue. The report cites an example of a taxpayer in Estonia who made several dozen small adjustments each day to turn a VAT liability into a refund without triggering intervention from the automated risk process. These risks are compounded for cross-border transactions: IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47, 17, 39.

199 IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47, 39; Bird and Gendron, *The VAT in developing and transitional countries*, above n 17, 139.

200 See above n 20.

understand and for administrators to apply.[201] By and large, the guidelines succeed in achieving a relatively simple approach to B2C supplies, but there are real issues around some aspects of the rules, as well as their implementation, which are likely to pose significant problems for some non-OECD countries that already struggle with taxing domestic B2C supplies.

The OECD Guidelines offer two main rules for B2C supplies of services and intangibles. The first general rule in guideline 3.5 applies to on-the-spot supplies, which traditionally encapsulated nearly all services. These include supplies which are physically performed at a readily identifiable place, are ordinarily consumed at the same time and place of physical performance and ordinarily require the physical presence of both the supplier and consumer at the time and place of performance. The OECD Guidelines provide examples, including services physically performed on the person (hairdressing, physiotherapy, beauty therapy), accommodation, restaurant and catering services, and the enjoyment of various recreational pursuits, such as entry to a cinema or museum and attendance at musical performances or sporting events.[202] Guideline 3.5 provides that for these on-the-spot supplies, "the jurisdiction in which the supply is *physically performed* has the taxing rights over business to consumer supplies of services and intangibles".[203] This rule provides a reliable indicator of final consumption due to the requirement that the supply ordinarily requires the physical presence of both the supplier and consumer at the time of the supply.[204] Unsurprisingly, this is the most straightforward rule to apply. The OECD Guidelines also recommend this approach for B2B supplies where appropriate (as an exception to the general B2B place of taxation rules permitted under guideline 3.7).[205] This might help relieve the suppliers of such services, who are often small and medium businesses, from needing to distinguish between businesses and final consumers and from needing to identify the customer location or usual residence, all in cases where there would often be very little time or inclination to do so.[206]

The second general rule applies for all other B2C supplies not covered by guideline 3.5 and provides that "the jurisdiction in which the customer has its *usual residence* has the taxing rights" for these supplies.[207] The OECD Guidelines clarify that *usual residence* is "generally where the customer regularly lives or has established a home".[208] The rule responds to the growing category of supplies that have been facilitated by the rise of technology, which allows the remote consumption of intangible goods and services where it is no longer guaranteed that traditional place of taxation rules

201 OECD Guidelines, 3.110.
202 OECD Guidelines, 3.117.
203 OECD Guidelines, 3.5 (emphasis added).
204 OECD Guidelines, 3.118.
205 See section 4.3.3 below.
206 OECD Guidelines, 3.119.
207 OECD Guidelines, 3.6 (emphasis added).
208 OECD Guidelines, 3.123.

that rely on the place of performance or the location of the supplier offer an accurate predictor of the place of final consumption.[209] This is particularly the case with digital supplies which are highly mobile, where the time and place of the performance of such supplies and their consumption often differs, and where consumption itself can be difficult to detect. For example, an Australian consumer might purchase an application, such as a translation service, developed in Singapore through a platform hosted in the UK and not actually use the application until holidaying in Argentina. However, the problem is not solely confined to digital supplies, but affects any service or intangible where the place of performance and consumption might differ from the place and time of supply, for example, services or intangibles that can be consumed remotely or on an ongoing basis, such as consultancy, accountancy and legal services, financial and insurance services, telecommunications and broadcasting services.[210]

Basing the place of taxation on *usual residence* reflects an assumption that this will ordinarily be where final consumption occurs. The OECD Guidelines state that the combined effect of guidelines 3.5 and 3.6 should mean that taxing rights accrue "where it can be reasonably assumed that the final consumer is actually located when consuming the supply".[211] The OECD Guidelines list advantages of this approach as being: that the location is readily identifiable; there is no tax advantage in buying from a low or no tax jurisdiction; and that it is reasonably practical for suppliers to comply with and for tax administrations to administer.[212] In addition, the OECD Guidelines recognise a degree of symmetry between the rules relating to B2B supplies and B2C supplies which both rest on a determination of the customer's location[213] and customer location is determined by the customer's business presence or establishment in the B2B context,[214] and the customer's usual residence in the B2C context.[215] Thus, they also account for jurisdictions that do not distinguish between B2B and B2C supplies, for which this symmetry is very relevant.[216]

However, establishing taxing rights on the basis of residence is open to a number of criticisms, three of which are addressed in turn here. The first is that the destination principle requires taxation in the jurisdiction of final *consumption* not *residence*. As the introduction to this article noted, it is important that the rules on the place of taxation be normatively grounded. However, the rationale for taxation on the basis of usual residence in the OECD Guidelines is convenience, that is, it is a technical compromise in the absence of having the technology available to support other

209 OECD Guidelines, 3.111, 3.112.
210 OECD Guidelines, C3, 3.10, 3.122.
211 OECD Guidelines, 3.115.
212 OECD Guidelines, 3.113.
213 OECD Guidelines, 3.2, 3.6.
214 OECD Guidelines, 3.2
215 OECD Guidelines, 3.6, 3.114, fn 33.
216 See section 4.3.1, step 4 of this article.

proxies which might more precisely determine the location of actual consumption for services and intangibles. Millar explains this in part as follows:[217]

> …destination means place of consumption, not residence of the consumer. In most situations, the practical effect of the destination principle may be that consumption is taxed where the consumer is resident, but this is because consumers mostly do consume things in their country of residence, not because VAT uses customer residence as the basis for asserting substantive jurisdiction.

It is, however, important to remember that, if taxing on a residence basis is a technical compromise rather than a normative decision, then as the technical capacity changes, there remains a normative commitment to continually revise the rules in light of this capacity. The OECD Guidelines themselves allow for this by stating that they are "evolutionary in nature and should be reviewed in light of relevant developments".[218]

For example, to the extent that the infrastructure in a poor destination country, such as mobile roaming or data services, has facilitated the consumption by a non-resident (for example, a wealthy tourist) in that jurisdiction, then this provides at least a normative (as well as a revenue) justification for taxing on the basis of something other than the usual residence of the consumer (perhaps on the basis of place of effective use or enjoyment,[219] or the actual location of the customer at the time of the supply). The current approach is that most jurisdictions use the country code of the SIM card or landline of the phone as a basis for establishing residence and tax on this basis. Such an approach provides certainty and is relatively simple to apply for the parties involved. In most cases, this will reflect the place of consumption (as presumably most use of the phone would occur at the consumer's usual place of residence) but this would not capture instances of use abroad as in this example. In the case where a phone is used abroad, there is scope under guideline 3.7 to account for this.[220] Generally, one can say that all proxies will be subject to criticism from a

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217 Millar, "Echoes of source and residence in VAT jurisdictional rules", above n 10, 284.

218 OECD Guidelines, preface, point 7.

219 For criticism concerning the use of such a rule, see, eg, Ecker, *A VAT/GST model convention*, above n 3, 135ff and T Ecker, "Place of effective use and enjoyment of services – EU history repeats itself" (2012) 23(6) *International VAT Monitor* 407.

220 The OECD Guidelines permit the use of the actual location of the consumer at the time of the supply as the proxy for consumption in circumstances where a service is performed at a readily identifiable location which requires the physical presence of the consumer but not the physical presence of the person performing it, such as the provision of internet access at an internet café or hotel lobby, use of a phone booth to make a call or access to pay per view TV channels in a hotel room. By extension, one could apply this to the provision of mobile roaming services in a particular country — however, often the payment of mobile roaming services is to the customer's local supplier and this might provide a barrier to taxing on this basis (especially in light of the normative criteria in 3.7, ie it might not be efficient to do so). See for more details section 4.3.3 below.

normative point of view because — as comes with their nature — they can always only ever be approximations of the actual place of consumption.[221]

As the above example suggests, a second criticism of the adoption of the customer residence proxy in the OECD Guidelines that is particularly relevant for non-OECD countries is that there are revenue implications that flow from taxing on a residence basis that may disadvantage poor countries.[222] If, for example, tourists make a large number of purchases in a developing country that are not on-the-spot supplies, such as the mobile roaming example, then taxing on the basis of usual residence, rather than other proxies such as the place of effective use or enjoyment or the actual location of the customer at the time of the supply, would result in revenue rights flowing to the residence country of the tourist at the expense of the developing country. Ultimately, the amount of VAT revenue for a given jurisdiction with respect to B2C services mainly depends on the purchasing power of the consumers in a country (higher for most OECD countries) and the amount of tourism.[223]

As it stands, the OECD Guidelines do permit revenue flowing to destination countries other than the jurisdiction of usual residence of the consumer both generally (through, for example, guideline 3.5 for on-the-spot supplies) and as a specific exception to the rules (for example, guideline 3.7 which permits taxing on the basis of other proxies in certain circumstances,[224] and guideline 3.8 which permits taxing services and intangibles on the basis of the location of immoveable property: see section 4.3.3).[225] It should also be noted that the OECD Guidelines do generate some revenue flows from wealthy to poor countries to the extent that people in poorer countries consume remotely supplied services, such as digital services, provided by firms established in richer countries (which would not necessarily occur under other proxies such as supplier location).[226] In any event, if increased technological capacity

221 See, for instance, the example given above about the download of translation software for a holiday in Argentina by an Australian resident through a platform hosted in the UK.

222 This is a common criticism of the OECD, *Model Tax Convention on Income and on Capital* (2015); cf, United Nations, *Model Double Taxation Convention between Developed and Developing Countries* (2011). See further Millar, "Echoes of source and residence in VAT jurisdictional rules", above n 10, 278.

223 VAT revenues also depend on the extent of input taxation of B2B supplies.

224 However, as the discussion in section 4.3.3 below shows, international distributional or inter-jurisdictional equity concerns would not be a basis for permitting the use of a special rule.

225 B2B supplies are mostly irrelevant from a revenue point of view as they should not give rise to revenue (unless there are input taxed supplies, or the jurisdiction does not have a VAT — but then the OECD Guidelines do not apply). The B2C rules can be beneficial for non-OECD countries (eg taxation on the basis of the location of immovable property benefits non-OECD destination countries — especially those with large tourism sectors because services connected to hotels should be taxed in the destination country).

226 Furthermore, if, for example, a US multinational generates significant profits through supplying e-services to individuals from India, it may be that India would not derive much corporate tax revenue under the OECD Model Convention but it will certainly generate a large amount of VAT

creates opportunities to revise the rules then this might also enable the distributional dimensions to be revisited.

The third criticism of the proxy chosen by the OECD Guidelines is that experience with applying the residence concept in the context of establishing taxing rights over international income suggests that the concept can be anything but straightforward.[227] To account for this, the guidelines permit reliance on a number of indicators to establish the usual residence of the customer.[228] Suppliers are entitled to rely on information that can be reasonably known at the time of supply[229] and which is available through the supplier's usual business model.[230] This could include information collected through the ordering process, such as address (and therefore jurisdiction), bank account details, credit card information and other appropriate indicia of residence, such as contact phone numbers and internet protocol (IP) addresses,[231] or geo-location data.[232] There is a risk that the information collected by the supplier might not be a reliable indicator of residence. Lamensch makes the point that it will be difficult for some suppliers to determine the usual place of residence of customers for digital supplies because barriers such as the limited interaction between the parties and the scarcity of reliable information all need to be overcome in very short time frames, indeed often in real time. For example, an IP address might be related to a device located at a second, rather than a primary, residence or relate to a device used while travelling, and bank account details are not always provided as is

revenue under the OECD Guidelines.

227 This point is acknowledged in the explanatory memorandum to the Australian legislation implementing the OECD approach: para 1.54 of the explanatory memorandum to the Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 (Cth). In this respect, however, it is worth noting that there are important differences concerning the implication of the residence concept for income tax and VAT purposes. For income tax, residence is usually determined by the taxpayer, generally in hindsight and with the consequence that the determination impacts all the income received by the taxpayer. In contrast, for VAT, usual residence must be determined by the supplier, at the time of supply (or because of consumer protection laws sometimes even before the supply, eg at the time of the offer) and it is generally determined for every supply separately. As a consequence, the OECD Guidelines seem to accept a certain minor degree of inaccuracy regarding individual transactions for the sake of manageability by the supplier. Since the inaccuracy is likely to concern only a (minor) part of the supplies received by the person, it is once again a pragmatic trade-off.

228 Although slightly counterintuitive, it might be argued that the indicators relied on to establish residence (such as billing and delivery address) are more straightforward to apply than the underlying theoretical concept of residence.

229 OECD Guidelines, 3.124.

230 OECD Guidelines, 3.126.

231 As the OECD Guidelines explain, an IP address is a numerical label assigned to a device participating in a computer network that uses the internet protocol for communication: OECD Guidelines, 3.127, fn 36.

232 See, eg, under the EU rules: art 24f(d), VAT Implementing Regulation (EU) 282/2011 as amended by Regulation (EU) 1042/2013.

the case, for instance, if payment is done by virtual currencies (eg bitcoin).[233] Perhaps the risk that the jurisdiction of taxation might not always reflect the place of usual residence (and presumably therefore of final consumption) might simply be the cost of having a workable regime. Furthermore, even if a different proxy were chosen, suppliers are likely to have limited information they can rely on and the result might be the same regardless of the proxy. So, for example, if a supplier only has recourse to an invoicing address and credit card information, the answer might be the same regardless of whether the place of taxation rule taxes on the basis of usual residence or another proxy (eg actual customer location at the time of sale).

If a jurisdiction chooses to follow the OECD Guidelines and bases its place of taxation rules on the proxy of usual residence, implementing the place of taxation rule in practice is a major challenge for B2C supplies because it generally relies on offshore businesses to remit the tax. The absence of border controls to monitor such supplies means that the system depends on overseas suppliers complying with tax systems in jurisdictions that have very little effective power to compel their compliance. The B2B solution of the reverse charge mechanism is not effective as it would require a large number of consumers to voluntarily comply with the collection of VAT with very little incentive to do so.[234] Traditional options which have required offshore suppliers to register and remit VAT are burdensome and therefore difficult to enforce.[235]

The response of the OECD Guidelines to this weak enforcement capacity is to encourage jurisdictions to make compliance as simple as possible through the adoption of a simplified registration and collection procedure for offshore suppliers. This might include features such as online registration,[236] simplified returns with an option to file electronically,[237] allowing for electronic payment of tax liabilities,[238] allowing for simplified record-keeping,[239] dispensing with the requirement to provide invoices[240] and keeping input tax recovery outside the simplified registration system.[241] Whatever the regime, the OECD Guidelines state that the guiding principle should be one of proportionality whereby registration-based collection mechanisms do not create compliance and administrative burdens disproportionate to the revenues involved

233 Lamensch recommends completely overhauling assessment and collection procedures for digital supplies: Lamensch, "The OECD international VAT/GST guidelines", above n 139 at 367.

234 OECD Guidelines, 3.130; for more details see Ecker, *A VAT/GST model convention*, above n 3, 143 et seq.

235 OECD Guidelines, 3.128

236 OECD Guidelines, 3.139.

237 OECD Guidelines, 3.141.

238 OECD Guidelines, 3.143.

239 Simplified electronic record-keeping might require that suppliers record the type of supply, date, VAT payable and the information used to determine where the customer has its usual residence: OECD Guidelines, 3.144.

240 OECD Guidelines, 3.145.

241 OECD Guidelines, 3.140.

or to the neutrality objective.[242] The OECD Guidelines recommend consideration of registration thresholds in support of this aim.[243]

The most advanced simplified system currently in place is the mini one stop shop (MOSS)[244] applied by the EU to B2C telecommunication, broadcasting and electronically supplied services. Under this system, EU and non-EU taxpayers that provide these services into an EU member state in which they are not established, can register, declare and pay the VAT in one single member state that subsequently distributes the tax to the member states of consumption. Such cooperation, however, requires high integration, a common legal base, a highly sophisticated IT infrastructure and extensive exchange of information within a strong administrative cooperation framework.[245] While a simplified registration system alleviates the compliance burden with respect to formal obligations (eg registration and declaration), it cannot (and is not intended to) reduce the previously described complexity that comes with the necessity to determine the place of taxation and the applicable rules in the jurisdiction of consumption (such as tax rates etc).

There are a number of vulnerabilities in this simplified registration approach, which the OECD Guidelines themselves acknowledge by the qualifier that it offers the best method at the "present time".[246] Two relevant problems for non-OECD countries are addressed here.

First, the heavy reliance on technology as the method to achieve simplification might present an issue for some non-OECD countries.[247] An IMF staff report estimates that information technology (IT) expenditure by national tax administrations is about 11–13% of total expenditure in developed countries and about 5–7% in emerging economies. Estimates for developing countries are not provided.[248] However, the same report notes that even when such countries might have substantially invested in IT infrastructure, there remain significant administrative issues. For example, many systems might collect data but are unable to leverage the data because of a lack of capacity to analyse it.[249] Many revenue systems still lack basic information such as data on collection performance; as one example, the Philippines still does not enter

242 OECD Guidelines, 3.150.

243 OECD Guidelines, 3.151 — a registration threshold might help tax administrations to focus their limited resources but may come at the cost of distortion of competition compared to domestic suppliers.

244 Arts 358ff, EU VAT Directive (2006/112/EC).

245 See, eg, EU Council Regulation on administrative cooperation and combating fraud in the field of value added tax (EU) 904/2010; Council Directive 2010/24/EU concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures.

246 OECD Guidelines, 3.131.

247 See, eg, "[t]his section recognises the important role of technology for the simplification of administration and compliance": Guidelines, 3.137.

248 IMF, "Current challenges in revenue mobilization: improving tax compliance, above n 47, 34.

249 Ibid 39.

all tax returns into its IT system.[250] While these factors may not be directly relevant to the operation of a simplified registration system, they do speak to the capacity of tax administrations to successfully monitor and maintain the system.

Second, this lack of infrastructure or capacity to support the simplified registration and collection procedure for which this rule depends is exacerbated by a lack of enforcement capacity in the event of non-compliance.[251] The above IMF staff report notes that "the B2C segment [already] presents acute compliance challenges" in the context of domestic supplies of tangible goods in developing countries let alone in the context of offshore supplies of intangible goods and services.[252] The lack of incentive for consumers to comply (for example, by requesting an invoice) plus the often existing lack of effective enforcement tools against suppliers means there is a real risk of non- or under-reporting of final sales.[253] Weak IT systems also provide opportunities for corruption, which is already a significant issue for many non-OECD countries.[254] Given the lack of enforcement capacity, a simplified registration and collection regime needs to be supported not just by technology, but also by administrative capacity-building and cooperation. This is acknowledged by the OECD Guidelines themselves which urge international cooperation to support VAT collection, as section 4.4 later explains.[255]

4.3.3 Specific rules

The OECD Guidelines outline two exceptions to the general rules. The first in guideline 3.7 permits the use of specific rules (such as the place of effective use or enjoyment or the actual location of the customer at the time of the supply) other than those provided in the general rules for B2B and B2C supplies. It also outlines the conditions on which a departure from the general rules would be justified. This involves a two-step process. *Step 1* involves considering whether the allocation of taxing rights by reference to the customer's location does not lead to an appropriate result in light of five enumerated criteria: (1) neutrality;[256] (2) efficiency of compliance

250 Ibid.

251 Lamensch writes of the B2C rules for other supplies (under guideline 3.6) that they are "economically relevant but much less easy to implement and to enforce" than the rules under guideline 3.5: Lamensch, "The OECD international VAT/GST guidelines", above n 139 at 369.

252 IMF, "Current challenges in revenue mobilization: improving tax compliance", above n 47, 29.

253 The problem in the domestic context has resulted in a variety of novel (and not necessarily effective) responses to encourage compliance, such as the use of lotteries whereby the production of an invoice allows the holder of the invoice to enter a lottery to win prizes. The IMF report states that there is little evidence that such approaches have led to substantial revenue gains and that such approaches should not substitute for traditional audit and enforcement activities: ibid 30.

254 Ibid 17, 39.

255 OECD Guidelines, 3.153.

256 Defined as the six guidelines on neutrality (2.1-2.16) and their commentary: OECD Guidelines, 3.159.

and administration;[257] (3) certainty and simplicity;[258] (4) effectiveness;[259] and (5) fairness.[260] *Step 2* involves considering whether a "proxy other than the customer's location would lead to a *significantly better result* when considered under the same criteria".[261] The OECD Guidelines stress that the analysis should be a holistic one.

It is undoubtedly useful to have an evaluative framework to assess the desirability of a specific rule against the background of a constantly changing technological and commercial environment which might prompt the need to consider it.[262] The emphasis that a departure from the general rules "should be limited to the greatest possible extent"[263] is a necessary reminder to prevent inconsistent approaches that might result in the double or non-taxation which the general rules seek to prevent.[264] The enumerated criteria are typical of norms traditionally used to assess the effectiveness of tax instruments. One might question whether such broad evaluative criteria are helpful, although the specific definitions of the five criteria assist in narrowing the scope of the inquiry while at the same time providing some guidance so that these aspects are not overlooked.[265] Of particular use is the provision of examples which would satisfy these evaluative criteria. So, for example, the OECD Guidelines permit the use of the actual location of the consumer at the time of the supply as the proxy for consumption in circumstances where a service is performed at a readily identifiable location which requires the physical presence of the consumer but not the physical presence of the person performing it. Such a situation would include the provision of internet access at an internet café or hotel lobby, use of a phone booth to make a call or access to pay per view TV channels in a hotel room.[266] Alternatively, the commentary highlights that the application of guideline 3.5 based on the place of

257 Defined as the minimisation of administrative and compliance costs: OECD Guidelines, 3.159.

258 Defined as rules that are "clear and simple to understand or that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how to account for the tax": OECD Guidelines, 3.159.

259 Effectiveness means that "tax rules should produce the right amount of tax at the right time and the right place": OECD Guidelines, 3.159.

260 Fairness is very narrowly defined as being that the "potential for tax evasion and avoidance should be minimised while keeping counteractive measures proportionate to the risks involved": OECD Guidelines, 3.159. The definition might more accurately be described as one encapsulating proportionality in responses to VAT avoidance and evasion rather than fairness as that term is traditionally understood in tax policy discussions.

261 OECD Guidelines, 3.7 (emphasis added). The need to engage in such a review of the appropriateness of a special rule shows the advantage of the rule for on-the-spot supplies in guideline 3.5 existing as a general rather than specific rule: see above section 3.2.

262 OECD Guidelines, 3.158.

263 OECD Guidelines, 3.160.

264 OECD Guidelines, 3.160; although, as explained in section 4.3.2 above, it should also be the case that changing technological and commercial environments should also entail a normative commitment to revise the general rules.

265 However, see above n 260, which highlights the very narrow scope of the fairness criterion.

266 OECD Guidelines, 3.167.

physical performance for on-the-spot supplies might not be appropriate when physical performance occurs across multiple jurisdictions, as might be the case for the international transport of a person. In this case, the location of the place of departure or the place of arrival might be a more appropriate proxy, although the guidelines do not specify this.[267]

Another example is contained in the specific rule in guideline 3.8 which provides that "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".[268] Such an approach reflects one commonly adopted in jurisdictions which use the location of immovable property for determining the place of taxation for services related to that property.[269] The OECD Guidelines offer a two-pronged approach to considering whether the application of this specific rule is appropriate. The first step identifies three general categories where a service or intangible might be *directly connected* to immovable property, such as when it consists of: (1) the transfer, sale, lease or right to use, occupy or exploit the immovable property; (2) services physically provided to the immovable property, such as construction or maintenance services; and (3) other supplies of services and intangibles not covered by (1) and (2) but that have a "very close, clear and obvious link or association with the immovable property".[270] The second step requires consideration of whether the special rule would lead to a *significantly better result* than the general rule. The OECD Guidelines state that it would be reasonable to assume this for categories (1) and (2), but that for category (3), the evaluative criteria outlined in guideline 3.7 should be applied.[271] The guidelines state that to sufficiently satisfy these criteria, the connection with immovable property "must be at the heart of the supply and must constitute its predominant characteristic".[272] The example of architectural services on specific immovable property is provided as a supply that would satisfy a sufficiently close connection.[273]

4.4 Supporting measures

As this article has demonstrated, the effectiveness of the OECD Guidelines will be in large part determined by the effectiveness of the measures to support their implementation. Chapter 4 of the OECD Guidelines specifically sets out these measures, including administrative cooperation, dispute resolution, taxpayer services and provisions on fraud and avoidance. Each is addressed briefly in turn.

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267 OECD Guidelines, 3.167.

268 OECD Guidelines, 3.8 (emphasis added).

269 OECD Guidelines, 3.168. The OECD Guidelines also note that some jurisdictions might base their place of taxation rules for a B2C supply around the location of movable property (for example, a repair service on a car): 3.180. The commentary states that the general rule for a B2B supply based on the customer's location should generally suffice in this instance: 3.181.

270 OECD Guidelines, 3.173.

271 OECD Guidelines, 3.174.

272 OECD Guidelines, 3.176.

273 OECD Guidelines, 3.179.

There are a number of legal and administrative measures beyond those contained in the OECD Guidelines that could support their implementation which are beyond the scope of this article.[274] In addition, there exist non-legal measures to encourage compliance. So, for example, one non-legal means of encouraging compliance is through emphasising the reputational advantages in doing so. In some respects, compliance with the obligations under the OECD Guidelines is a relatively easy way to maintain or restore reputations for non-resident entities, given that they do not directly bear the economic burden of the VAT themselves and assuming that they have the capacity to comply. Initial experience with early adopters of the OECD Guidelines suggest that large non-resident suppliers (or intermediaries) might indeed be willing and able to comply. However, it should be noted that the capacity to apply this public reputational pressure is not evenly distributed among all countries — the capacity of small non-OECD economies is clearly not equivalent to the capacity of large market OECD countries.[275] As a result, sound tax administration backed up by sufficient international cooperation will also be required.

4.4.1 Administrative cooperation

Effective administrative cooperation is crucial to the implementation of the OECD Guidelines because of the increasing relevance of effective tax collection from non-resident entities. This, paired with the further internationalisation of trade as well as that of organised crime, make administrative cooperation one of the key issues for the near future.[276] The OECD Guidelines rely on existing legal frameworks for establishing this cooperation.[277]

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274 Such measures might include the closure or blocking of non-compliant provider websites. For an Australian example of such a power see, eg, *Telecommunications Act 1997* (Cth), s313. For a discussion of the use of this power in the context of Australian attempts to remove the threshold that prevents levying the GST on the importation of low value goods, see, eg, Jackson Stiles, 'ATO has the power to block shopping websites, and isn't afraid to use it', *The New Daily* (online), 15 September 2016 <http://thenewdaily.com.au/money/your-budget/2016/09/14/shopping-websites-blocked/>.

275 OECD/G20, BEPS action 1: *addressing the tax challenges of the digital economy*, above n 3, 136; *contra* submissions by major retailers and intermediaries opposing proposed reforms to remove the threshold that excludes the GST from applying to the importation of low value goods in Australia: see eg ASOS, Submission No 2 to Australian Senate Economics Legislation Committee, *Treasury Laws Amendment (GST Low Value Goods) Bill* 2017, 3 April 2017; Alibaba, eBay and Etsy, Submission No 27 to Australian Senate Economics Legislation Committee, *Treasury Laws Amendment (GST Low Value Goods) Bill* 2017, 12 April 2017. Although relevant to the separate (albeit related) issue of low value goods these submissions indicate that reputation alone cannot achieve compliance.

276 The delegations to the Third Global Forum on VAT, for instance, urged the OECD to undertake further work which could "include the development of a possible framework for the exchange of information and enhanced administrative co-operation in the area of VAT": Third Meeting of the OECD Global Forum on VAT Paris, above n 3. Also the OECD Guidelines themselves recognise the merits of the future development of additional guidance (see OECD Guidelines, 4.11). Thus, it is fair to believe that this will be one of the main areas of work of the Committee on Fiscal Affairs and its subsidiary bodies in the area of VAT in the near future.

277 See OECD Guidelines, ch 4, para 4.12 et seq.

The most important existing instrument for administrative cooperation is likely to be the OECD/Council of Europe multilateral *Convention on Mutual Administrative Assistance in Tax Matters* (Mutual Assistance Convention).[278] The Mutual Assistance Convention applies to general consumption taxes including value-added or sales taxes (as well as income and other taxes),[279] and is not restricted to residents or nationals.[280] The administrative assistance it promotes comprises exchange of information, assistance in recovery (including measures of conservancy)[281] and service of documents.[282] The main methods envisaged by the Mutual Assistance Convention are exchange on request,[283] automatic exchange,[284] spontaneous exchange,[285] simultaneous tax examination,[286] and tax examination abroad.[287] Exchange of information under the Mutual Assistance Convention is, however, not restricted to these methods.[288] Currently, many countries have made reservations to certain aspects of the Convention.

In addition to the Mutual Assistance Convention, income tax treaties are probably the most important instrument for administrative cooperation. According to art 26(1) of both the OECD and the UN Model Conventions:[289]

278 OECD/Council of Europe, *Convention on Mutual Administrative Assistance in Tax Matters*, 1988, as amended by the 2010 protocol (Mutual Assistance Convention). Available at www.oecd.org/tax/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm.

279 See art 2(1)(b)(iii)(C) of the Mutual Assistance Convention.

280 See art 1(3) of the Mutual Assistance Convention.

281 A state seeking assistance from another state with the recovery of a tax debt can request the other state to take measures of conservancy (such as the seizure or freezing of assets) to preserve assets while the recovery process takes place: OECD/Council of Europe, "Revised explanatory report to the Convention on Mutual Administrative Assistance in Tax Matters" as amended by 2010 protocol, para 123 et seq.

282 See art 1(2) of the Mutual Assistance Convention.

283 See art 5 of the Mutual Assistance Convention; this is the furnishing by the requested state of information relating to a particular case to an applicant state which has specifically requested it.

284 See art 6 of the Mutual Assistance Convention; automatic exchange means the systematic sending of information concerning specified items of income or capital from one party to another.

285 See art 7 of the Mutual Assistance Convention; spontaneous exchange is the passing on of information obtained during examination of a taxpayer's affairs or otherwise, which might be of interest to the receiving state.

286 See art 8 of the Mutual Assistance Convention; simultaneous tax examination signifies the furnishing of information obtained in the course of the simultaneous examination in multiple states, on the basis of an arrangement between two or more competent authorities, of the tax affairs of a person, or persons in which these states have a common or related interest.

287 See art 9 of the Mutual Assistance Convention; tax examination abroad includes the presence of representatives of the tax administration of the applicant state at an examination of a tax matter in the requested state in order to obtain relevant information. For an overview of all of the measures, see "Explanatory report on the Mutual Assistance Convention", para 51.

288 See "Explanatory report on the Mutual Assistance Convention", para 52.

289 United Nations, *Model Double Taxation Convention between Developed and Developing Countries* (2011).

> The competent authorities of the Contracting States shall exchange 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, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention.

The OECD commentary even explicitly provides an example of a case concerning VAT that is covered by the provision.[290] Article 26(1) of the Model Conventions further establishes that the exchange of information is not restricted by art 1 of the Model Conventions, with the effect that it can also cover information related to non-resident persons. It should be pointed out, however, that many states for different reasons[291] have not included such extensive exchange of information provision in their tax treaties.

Modern income tax treaties generally also provide for assistance in the collection of taxes. Article 27 of the OECD and UN Model Conventions, for instance, provides that "[c]ontracting States shall lend assistance to each other in the collection of revenue claims". The term "revenue claim" is defined as an "amount owed in respect of taxes of every kind of description" and hence also includes VAT claims. Again, in practice many income tax treaties do not contain such a provision.[292]

Another legal framework for information exchange in tax matters involves tax information exchange agreements (TIEAs). In 2002, the OECD developed a *Model agreement on exchange of information on tax matters* (OECD Information Exchange Model), which serves as the basis for many information exchange agreements.[293] The model is presented both as a bilateral and a multilateral agreement. In practice, however, TIEAs rarely cover VAT. The wording of the OECD Information Exchange Model does not *prima facie* suggest that it applies to VAT, but rather that it can apply if the parties so choose. Article 3(2) of the multilateral version of the agreement states that "[t]he Contracting Parties, in their instruments of ratification, acceptance or approval, may agree that the Agreement shall also apply to indirect taxes".

Further legal bases for exchange of information may be agreements from other fields of law or the provisions in the domestic law of a country.[294] The same applies for assistance in recovery of taxes.[295]

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290 See OECD commentary, art 26, para 8(d), that gives the following example of information relevant to the implementation of domestic law: "State A, for the purpose of verifying VAT input tax credits claimed by a company situated in its territory for services performed by a company resident in State B, requests confirmation that the cost of services was properly entered into the books and records of the company in State B".

291 For more details, see Ecker, *A VAT/GST model convention*, above n 3, 413.

292 For more details, see Ecker, *A VAT/GST model convention*, above n 3, 420 et seq.

293 OECD, *Model agreement on exchange of information on tax matters* (2002).

294 See Ecker, *A VAT/GST model convention*, above n 3, 416 et seq.

295 Ibid 423 et seq.

Given the importance of administrative cooperation in effectively realising the OECD Guidelines, it is important for general moves towards further administrative cooperation in the area of VAT (ie adherence to the Mutual Assistance Convention, removal of reservations, and/or conclusion of treaties) to continue and that OECD countries lead by example. In the context of non-OECD countries, it is important that these jurisdictions not simply be overwhelmed by requests for assistance and instead are provided with appropriate capacity-building and support to both make and respond to such requests.[296] As with all instances of cooperation, there needs to exist an incentive to cooperate. There is obvious room for improvement when it comes to cooperation in tax matters.[297] An economic union provides incentives to cooperate, but beyond this context, there is a question of what constitutes sufficient incentive to cooperate at the international level. As revenue becomes more difficult for states to collect on their own, and more and more jurisdictions face similar challenges, then cooperation might lead to a win-win situation and the incentive to cooperate might be strengthened over time.

4.4.2 Dispute resolution

While the OECD Guidelines intend to reduce possibilities for disputes by aiming at the alignment of national VAT rules, they will not succeed in fully preventing disputes. Thus, the guidelines can be seen as a significant step to reduce disputes and resolve the issue of VAT double- and non-taxation. Disputes regarding their interpretation could lead to more precise guidelines and thus further reduce the problem. However, because of their non-binding character, the guidelines may be unsuitable to resolve disputes in a specific case and are insufficient to completely avoid future disputes and eliminate double taxation.[298]

4.4.3 Taxpayer services

In order to facilitate the implementation of the OECD Guidelines, the guidelines recommend taxpayer services as a way in which tax administrations might be able to support consistent interpretation, if such services are not inconsistent with national law and practice.[299] Such services might include local guidance on the domestic VAT

296 See above, text at nn 67–70.

297 Although not an incentive to cooperate, it might be argued that the VAT reduces barriers to cooperate that exist under the income tax. The allocation of VAT revenue might be less controversial because, unlike income taxes, a tax claim of one country (eg, source state) usually does not reduce the tax claim of another country (eg, residence state). Instead it is the jurisdiction of consumption that should have the claim (provided that the states in question can agree on what is the jurisdiction of consumption). See further Ecker, *A VAT/GST Model Convention*, above n 3, 389ff.

298 See OECD Guidelines, 4.9; for more details see also Ecker, "Digital Economy International Administrative Cooperation and Exchange of Information in the Area of VAT", above n 104, 141, 153 et seq. and 158 et seq.

299 For more details see OECD Guidelines, 4.17 et seq.

rules that fall within the scope of the guidelines and specific contact points within revenue administrations where businesses can report perceived disparities in the interpretation or implementation of the guidelines between different countries.[300] The rationale for these services is to help businesses that try to be fully compliant by providing them with the necessary information and means to do so.

4.4.4 Fraud and avoidance

The OECD Guidelines are only meant to apply if all parties involved act in good faith and all transactions are legitimate and have economic substance. In case of evasion and avoidance, the guidelines recognise that jurisdictions may want to take appropriate and proportionate measures to protect themselves against the negative effects of such behavior, even if it means a deviation from the general content of the guidelines.[301] Again, however, this presupposes the capacity of jurisdictions to detect avoidance and evasion in the first place, which is more likely to be an issue for non-OECD countries.

5. Conclusion

The OECD *International VAT/GST guidelines* are a significant step in the effort to achieve a degree of global coordination around the place of taxation rules for cross-border trade in intangibles and services. This article has demonstrated that the OECD Guidelines are relevant for all jurisdictions with a VAT (and perhaps even for some without one). However, the assessment of whether they are suitable or achievable for a given jurisdiction is a broader inquiry that is beyond the scope of this article. Nevertheless, this article has highlighted a number of technical challenges within the guidelines that are likely to confront all jurisdictions that seek to implement the approach. These include clarifying the scope of key concepts such as "permanent business presence" and "establishment" in the B2B context, as well as monitoring the appropriateness of the place of taxation rules for B2C supplies. A significant issue for many non-OECD countries is that, although the guidelines offer a degree of uniformity to determining the place of taxation, they — like any other solution for a VAT system that is designed to tax final consumption — presuppose robust administrative and compliance capabilities to give effect to these rules. As this

300 OECD Guidelines, 4.18.

301 For more details, see OECD Guidelines, ch 4, para 4.22 et seq. The guidelines do not provide specific examples. There are many potential schemes that might warrant a response. For example, a common avoidance technique in the gaming industry is to artificially interpose a foreign business into an otherwise domestic business chain in a jurisdiction that input taxes such supplies so that the otherwise irrecoverable VAT occurs abroad. The existence of such a scheme should permit countries to deviate from the guidelines, although this might not be necessary if it was possible to respond to such a scheme with a specific rule under guideline 3.7 (especially in light of the "fairness" criterion).

article has shown, this capacity has traditionally been difficult to realise for many resource-constrained non-OECD countries.

On the one hand, the question of administrative capacity might be considered relevant to the *prior* question of whether a country should adopt a VAT in the first place. Once the decision has been made to adopt a VAT, then adopting the guidelines should follow as they do not necessarily add to the burden of effectively administering a VAT and in some cases, might even reduce it.[302] Alternatives may lead to higher compliance costs, carry their own avoidance and fraud risks and entail inconsistent place of taxation rules or just the simple non-taxation of cross-border supplies of services and intangibles altogether.

On the other hand, given that the prior question has for the most part already been answered in the affirmative and there are now more than 150 real VATs in existence, many of which are not supported by sufficient administrative capacity, then considering whether the OECD Guidelines are not only relevant but suitable or achievable should also entail a consideration of whether the country has the capacity to give effect to them. For example, as this article has shown, clearly countries can run VAT systems that do not distinguish between B2B and B2C supplies, but continuing to do so hampers the ability to give full effect to the preferred method favoured by the guidelines of collecting tax on B2B supplies (the reverse charge). The guidelines — like any other VAT system — heavily depend on the capacity of tax administrations to give effect to them. If the respective capacity is lacking, then the result might be no better than the alternatives. For this reason, jurisdictions should always carefully consider the implications that come with the rules in light of their capacity to give effect to them.

Exacerbating this issue of capacity is the international coordination required to give effect to the rules, given the weakness of any one jurisdiction to enforce them. To achieve their desired effect, the OECD Guidelines should be matched by concerted action to realise this coordination, as well as a significant capacity-building effort that takes appropriate account of the domestic institutions and constraints within each non-OECD jurisdiction so as to ensure that the OECD Guidelines are not merely relevant, but also suitable and achievable.

302 See, for example, the discussion of the advantages of the reverse charge mechanism, including the avoidance of cross-border refunds (above at 4.3.1); the suggestion within the OECD Guidelines of a threshold for the taxation of B2C supplies (see above 4.3.2). There is also the possibility that the OECD Guidelines offer a simplification of complicated rules already in place in certain jurisdictions.