IRAS-OECD Regional GST/VAT Conference (May 2013)
Taxing cross-border supply of services and intangibles

Case Studies
Technical Summary of discussions

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Introduction

GST/VAT - A tax collected through staged process [(2)]

1. The GST/VAT is a broad-based tax imposed on final consumption but the amount of tax corresponding to its margin (i.e. on the difference between the VAT paid out to suppliers and the VAT charged to customers) is collected and remitted to the tax office by each registered business (i.e. supplier) in the supply chain[(3)].

2. This means that, in the context of cross-border trade, the staged collection process is breached because the consumer (the economic bearer of the tax) and business (the payer of the tax) are in different jurisdictions. The destination principle, under which tax revenue belongs to the jurisdiction where consumption takes place, is unanimously accepted among participating countries of the IRAS-OECD Regional GAT/VAT Conference (hereinafter "conference"). The application of the destination principle achieves neutrality in international trade and would improve efficiency. This is specifically relevant to Asian economies as they are important both in terms of a place for production and as a large market with thick middle-class to international businesses working in the global value chain.

Implementing the destination principle

3. Although there is the widespread acceptance of the destination principle among participated countries, practical means of implementing may be different across countries. Two case studies on cross-border supply of services and intangibles discussed at the conference involved a number of cutting-edge issues that highlight key considerations in implementing and administrating applying VAT/GST to international trade.

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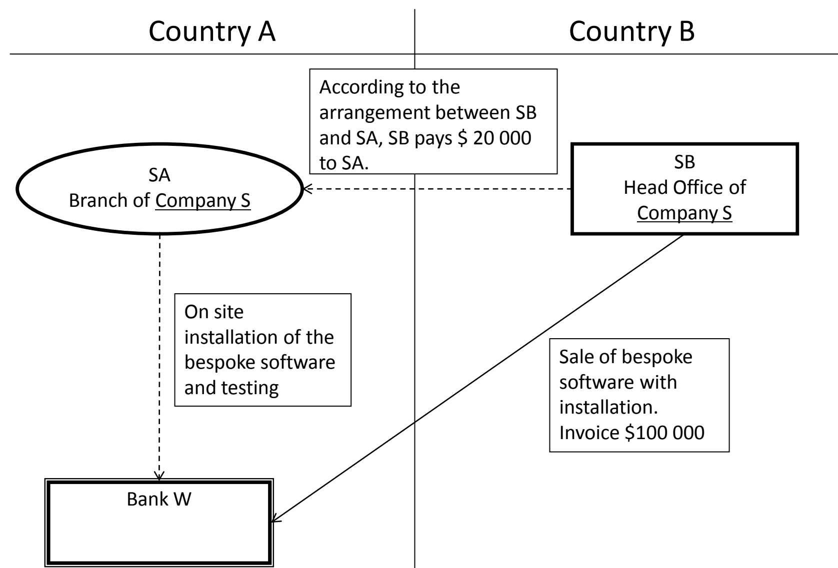
(1) Senior Advisor (International), NTA, Japan. The Rapporteur is grateful for generous support/input received from the Inland Revenue Authority of Singapore and participants of the Conference.
(2) Core features of GST/VAT are discussed in Chapter 1 of "OECD International VAT/GST guidelines" available at www.OECD.org
(3) The GST/VAT is also collected, under certain specific circumstances, from taxpayers other than registered businesses in the supply chain. For example, intermediaries (e.g. Customs collect tax on imported goods) or consumer (e.g. use tax in the US) or businesses receiving cross-border supply of services and intangibles (i.e. through reverse charge mechanism).

4. This note summarizes the key technical issues discussed in the Session 4 of IRAS-OECD Regional GST/VAT Conference (May 2013).

Case Study 1: Cross-border Business to Business supply of service an intangibles (ANNEX 2)



Treatment of a mixed supply for GST/VAT purposes: Single vs. multiple supplies

5. An interesting issue discussed in the case study 1 was where a contract consists of elements of cross-border supply (i.e., sale of software) and domestic supply (i.e., onsite installation), can or should the (package of) supply be treated as one single supply (of either cross-border or domestic nature) or as a combination of cross-border and domestic supplies

6. Participants who expressed their views considered unanimously that the bona-fide (package of) supply is not separable for GST/VAT purposes and should be treated as a single supply.

7. Furthermore, for GST/VAT purposes, countries do not "deem" cross-border supply of services and intangibles within the same legal entity, (i.e. SB (head office) and SA (branch)), nor between entities (i.e. SA and W) where there is no contractual arrangements for services furnished by SA

Place of taxation: Country A (recipient) vs. Country B (supplier's office)

8. The majority of participants who responded considered that the place of taxation should be country A, i.e., the country where the recipient has located its business presence (in this case, bank W). The amount of GST/VAT would be collected from the recipient (i.e., bank W) through the application of

reverse-charge mechanism[4]. This approach seems to be most compatible with the definition on the place of consumption and recommendation on collection mechanism options mentioned in early OECD works [5].

9. Two countries considered that the place of taxation is NOT country A because there is a single supply (see above) and the place of supply (and thus taxation) should be the place of office used for furnishing such service (supplier's location) because of the fact that the contract for furnishing services and intangibles in question is made between SB and W[6].

Collection mechanism: Registration vs. reverse charge

10. In Country A, the tax could be collected from SB (foreign supplier through registration) or, alternatively, from SA (domestic office of S). As stated above, most countries would apply reverse charge mechanism and collect tax from the domestic recipient Bank W, even though S has a business establishment (branch) in Country A.

11. Under the staged collection mechanism, GST/VAT is collected from the supplier. However, reverse charge mechanism is used to avoid placing an administrative burden on foreign suppliers which do not have business presence in the country of recipient [7].

12. So long as there is a business presence of the foreign supplier, it may be reasonable to oblige such foreign supplier to register and pay GST/VAT [8].

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(4) The "*reverse-charge mechanism*" is a tax mechanism that switches the liability to pay the tax from the supplier of service and intangible property to the recipient. See footnote 35 of OECD International VAT/GST guidelines draft consolidated version (Feb 2013).

(5) Recommendation on collection mechanism options at box 3 of a report o the Committee on Fiscal Affairs "taxation framework conditions" (1998) presented to Ministers at the Ottawa OECD Ministerial Conference (1998).

(6) Elements that most directly affect this conclusion could, apart from the contract, include elements such as the main part of the arrangements (in this case study, the sale of software) and the fact that installation service furnished by SA is of an auxiliary nature.

(7) "1.14 Making exports free of VAT, and taxing imports, introduces a breach in the staged collection process. In most countries where an invoice credit method is used, the VAT on cross-border business-to-business supplies of services and intangibles is usually collected by the reverse charge mechanism. This is a tax mechanism that switches the liability to pay the tax from the supplier to the customer. <u>In the absence of such a mechanism, foreign suppliers that deliver services in countries where they are not established would in principle have to register for VAT purposes and fulfil all VAT obligations in that country</u>. To avoid such administrative burdens on foreign providers, and to assure that VAT is accounted for, the reverse charge mechanism allows (or sometimes requires) the VAT-registered customer to account for the tax on supplies received from foreign traders. If the customer is entitled to full input tax credit in respect of the supply, it may be that local VAT legislation does not require the reverse-charge to be made. However, the reverse charge mechanism is not applied in all jurisdictions and, where it is implemented, the rules may differ from country to country."

Source: OECD International VAT/GST guidelines draft consolidated version (Feb 2013) Underline added.

(8) The scope of tax collection under the use of reverse charge mechanism would be wider because (high) turnover threshold may be applied for registered businesses but there is generally no turnover

13. One country (Australia) would collect, a part of GST on the sale of software that was not performed in Australia (cross-border nature) from W through reverse charge mechanism, and a part of GST on the installation service that is performed in Australia (domestic nature) from the supplier, entity SA. In Australia SA and SB are treated as the one entity.

Effect on neutrality and tax revenue

14. Taxation of import of service and intangibles would not affect the amount of GST/VAT revenue in Country A because input tax credit is not given. However, where the recipient is not given the full right to deduct input tax (as in this case study, for example, banks) the amount of GST/VAT on imported service and intangibles would be final and thus would affect tax revenue and neutrality. A participating country commented that it is important to tax import of services in order to provide level-playing-field for domestic ICT industries which is critical, in the opinion of that country for its industrial development.

Destination principle: the degree of achievement

15. All participating countries apply zero rates for export of service if they are country B and thus achieving the destination principle. It may, however, be considered as incomplete achievement of the principle where a country cannot effectively tax import of service or intangibles.

Where SA and SB are different legal entities (instead of a head office and branch)

16. All participating countries considered that supply of service by SA to SB is subject to independent GST/VAT treatment. The supply of service by SA to SB ($20,000) will be zero-rated for export except for Australia and Singapore. In Australia the service supplied by SA to SB is connected with Australia because the supply is performed in Australia to another entity in Australia, being W, and not zero rated (GST-free). In Singapore because the installation service is physically carried out in Country A and furnished to Bank W on behalf of SB it is not zero rated.

Possible loss of revenue in Country A

17. If Country A were to allow "SA" (a branch of foreign supplier) to deduct input tax incurred for the furnishing installation service to Bank W, Country A might be viewed as losing GST/VAT revenue "twice" because, (1) Country A would lose the tax on imported software purchased by Bank W (the scope of input tax credit for banks is limited as banks do not generally have taxable sale), and (2) "SA" is likely to obtain refund on input tax as it does not have taxable sale through "voluntary registration" if this is allowed in Country A(9).

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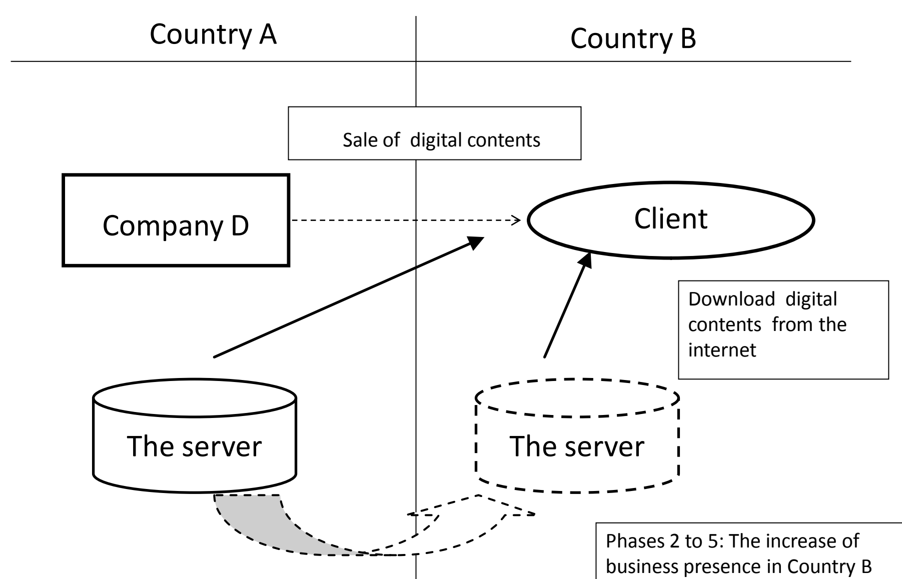
threshold applicable to reverse charge mechanism. Australia does apply a turnover threshold to reverse charge. However most entities subject to reverse charge in Australia would choose to register anyway.

(9) In some countries, voluntary registration by foreign supplier is not allowed or restricted. For

Case study 2: Cross-border Business to Consumer supply of service and intangibles (ANNEX 3)



18. This case study examined how the destination principle can be implemented where the recipient of cross-border supply of service and intangibles is the final consumer (i.e. not a business).

19. The application of destination principle would require that the tax revenue on such cross-border supply of service should belong to the country of consumption - which appears to be Country B(10).

20. Through five phases examined in the case study, the business presence of the foreign supplier was increased. The key questions discussed were, what would trigger different GST/VAT treatments, i.e.,
    (a) What will "trigger" taxation in Country B and on what basis?
    (b) Who should the taxpayer be and which tax collection mechanism is applied?

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example, in NZ, voluntary registration is currently available only for foreign suppliers making taxable supplies in NZ. (From 1 Apr 2014, non residents without taxable sales in NZ will be allowed to register and claim GST).

(10) In reality, a number of questions need to be asked before determining the definition of the place of consumption. For example, the early OECD work recommended "usual jurisdiction of residence" of consumers as the definition of place of consumption.

The table below illustrates responses of participants

	Country A (Supplier)	Country B (Consumer)			
Method of tax collection	Registration	Registration as a foreign supplier	Registration (as a domestic supplier)	Collection from an intermediary	Declaration
Taxpayer	Company D (zero rate for export)	Company D	Company D (domestic office)	Banks	Clients
Phase 1 (Foreign supplier has no business presence in country B)	Vietnam Singapore Malaysia Philippines Sri Lanka Japan	Norway NZ		Bangladesh	Indonesia Thailand PNG
Phase 2 (foreign supplier has a rented server in country B)	●——	——→	Philippines		
Phase 3 (foreign supplier owns a server in country B)	●——	——→	Vietnam		
Phase 4 foreign supplier buy service (for maintenance, etc.) in country B			Bangladesh ←—	—●	
Phase 5 foreign supplier employ staff (for maintenance, etc.) in country B	●—— ●—— ●——	——→ ——→ ——→ ●——→ ●——→	Malaysia Singapore Sri Lanka Norway NZ Indonesia ←— Thailand ←— PNG ←—	 —— —— ——	 —● —● —●

N.B. General caveat: This table is prepared based on random responses of government and private sector participants during the Session 4. Analyses could be different in real cases depending on facts and circumstances.

What will "trigger" taxation in country B

21. A number of participants considered that foreign supplier would be subject to tax as domestic businesses when they have sufficient business presence in country B. However, the degree of business presence is different. Most participants considered that owning a business establishment would trigger taxation in Country B (phase 5).

Different tax collection mechanisms

22. Participating countries apply different collection mechanisms before the stage where the foreign supplier becomes a registered GST/VAT taxpayer.

(a) Self assessment

23. In some participating countries (e.g., Thailand [11], Indonesia [12]), importers of goods and services are obliged to pay tax. However, it is widely recognized that in the case of import of services it is not easy to enforce the rule in practice.

(b) Simplified registration of foreign business (e.g., Norway)

24. Purchases of electronic services from abroad (import) by customers in Norway is subject to VAT at the standard rate of 25% (2011 tax reform). Foreign vendors are obliged to pay the tax by communicating electronically with any tax office in Norway. Foreign vendors do not have to appoint a representative or register in the Central Coordinating Register for Legal Entities. Foreign vendors will not be able to deduct input VAT in the VAT return, but will be eligible for input VAT refund applications. According to the presentation made by the Norwegian participant, the revenue was above initial projections and the number of simplified regulations was satisfactory. The largest known cross-border suppliers of global electronic services B2C have complied with the simplified schemes or by ordinary registrations.

(c) Collection from intermediary (e.g., Bangladesh)

25. In Bangladesh, banks have responsibility for deduction of VAT from the cross border transactions. Bangladeshi consumer's purchases of anything from abroad staying in Bangladesh are subject to such deduction. The Bangladesh VAT law defines such transactions as "Import of Service". Consumers have to pay "Consideration" for these transactions by Credit/Debit/other business Cards or Account Transfer. All Local and International Cards are affiliated with a Bank. During payment of "Consideration" the bank adds 15% VAT to the purchase value. Banks transfer the purchase value to the foreign seller and pay 15% VAT to the Bangladesh government treasury on behalf of the consumer [13].

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(11) Section 83/6 of the Revenue Code. See ANNEX1 for informal translation.
In Thailand, person who makes payment for imported service to use in Thailand has to remit VAT to the tax authority (Section 83/6 or the Revenue Code). However, in practice it is normally VAT registrants in Thailand that remit VAT when making payment for imported of services to use in Thailand as they can claim such VAT as input tax.

(12) Article 4 of the VAT

(13) Section 6(3) of the Value Added Tax Act (1991). See ANNEX1 for informal translation.

ANNEX 1

Informal translation

Collection of GST/VAT from cross-border supply of services and intangibles

Thailand (Self assessment of VAT)

Revenue Code

The section 83/6 of Revenue Code

Where the payment of goods or services is made to the following business persons, the payer for goods or services shall be required to remit value added tax amount which the business person is liable
(1) business person residing abroad who temporary carries on the business in sale of goods or provision of services in Thailand and does not temporarily register for value added tax in accordance with Section 85/3;
(2) business person providing services abroad and such service is used in Thailand;
(3) other business person as prescribed in Royal Decree; Paragraph 2 of Section 83/5 shall be applied.

Bangladesh (Collection of VAT by banks)

Value Added Tax Act, 1991:

Section 6(3): Value Added Tax shall be payable by,-
(a) in case of imported goods: the importer at the stage of import
(b) in case of manufacturer or producer: the supplier at the stage of manufacturing or producing
(c) in case of service rendering: the service renderer
(d) in case of supply of services from outside the geographical area of Bangladesh: the recipient of service, and
(e) in other case, the supplier of service receiver.

Section 6(4aa): Notwithstanding any other provision of this act, Value Added Tax payable by any service renderer (provider) selected in this behalf by the Government, by notification in official Gazette, from time to time, shall be collected or deducted at source, in the procedure specified by the Board, at the time when the person receiving the service or as the case may be, the person making payment of the value of the service and shall be deposited to the Government Treasury.

Value Added Tax Rules, 1991:

Rule 18A.- Value Added Tax deduction at source by recipient of supply.-
(3) The payable Value Added Tax shall be deducted by bank or any other financial institution while making payment by service recipient under clause (d) of sub-section (3) of section 6 of the Act (i.e. the Value Added Tax Act, 1991).

ANNEX 2

GST/VAT CONFERENCE SINGAPORE

SESSION 4 - CASE STUDIES

In the case studies below, all parties involved act in good faith and all supplies are legitimate and with economic substance. Issues connected with tax evasion and avoidance should not be addressed as part of these case studies

Case study # 1 – Business-to-Business transactions

Company S is specialised in bespoke accounting software development for business clients. Company S has its Head Office in Country B (SB) and a branch in Country A (SA). SA and SB are part of the same legal entity but are registered for VAT purposes in both Countries A and B where they run a business.

Bank W located in Country A contracts with SB, the Head Office of Company S, for the development and installation of bespoke software (i.e. a software is developed by SB for the specific needs of W). They agree on a price of $ 100 000. The contract provides that employees of Company S shall visit the premises of bank W in Country A to install the software (installation includes the assessment of W's hardware infrastructure, installation of the software and testing).

Company S' engineers in the Head Office SB develop the bespoke software. The software is downloaded from the premises of SB in Country B on the computers of bank W. According to an arrangement between the Head Office of Company S (SB) and its branch in Country A (SA), employees of SA visit the premises of Bank W to assess the hardware infrastructure, install the software and proceed to the appropriate tests before final delivery. There is no contract or any direct arrangement between Bank W and branch SA.

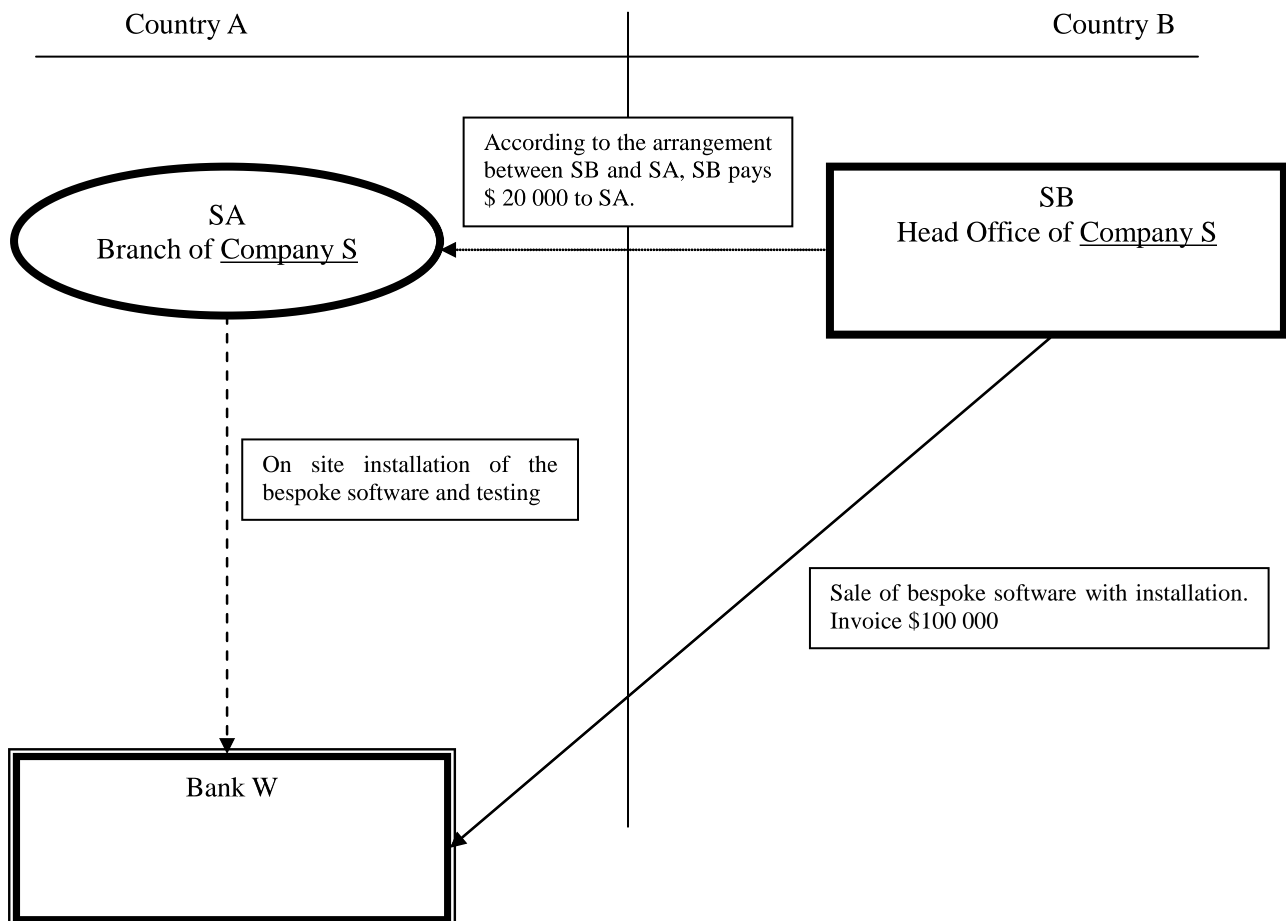
When the software is installed on its computers and the test phase is completed, bank W pays $ 100 000 to SB. Following the arrangement between the Head Office SB and its branch SA, SB pays $ 20 000 to SA for its involvement in the transaction. This amount covers the cost of the assessment of the hardware infrastructure and installation/testing of the software by SA's employees.

Questions

Question 1: how would you treat the supply of bespoke software, (including the assessment of the hardware infrastructure, installation of the software and testing) from Company SB to Bank W for GST purposes?
a) Is there one single cross-border supply of services from SB to W? If yes, where is the place of supply/taxation of that supply and who would be liable to pay the GST/VAT to the tax authorities in Country A?
b) Is there one single domestic supply from SA to W in Country A despite the fact that there is no contract or arrangement between SA and W and that the payment is made from W to SB?
c) Are there two different supplies: a cross-border supply (software development) from SB to W worth $ 80 000 and a domestic supply (installation) from SA to W worth $ 20 000?
d) Any other treatment?
e) What would be the GST treatment if SA and SB would be two different legal entities (separate companies belonging to the same group) where SB has subcontracted the installation of the software to affiliate SA?

Question 2: how would you treat for GST/VAT purposes the arrangement between the Head Office of company S, SB and its branch SA considering the answers given to Question 1 a) – d)?
a) In case where there is a (deemed) cross-border supply of services from SA to SB, where would be the place of supply/taxation and what would be the tax base?
b) In case where there is no (deemed) cross-border supply of services from SA to SB, is it because the supply from SA to SB is considered as a "non-supply" (arrangement within the same legal entity) or because it is simply ignored given the circumstances of the case?

CASE STUDY # 1



ANNEX 3

GST/VAT CONFERENCE SINGAPORE

SESSION 4 - CASE STUDIES

In the case studies below, all parties involved act in good faith and all supplies are legitimate and with economic substance. Issues connected with tax evasion and avoidance should not be addressed as part of these case studies

Case study # 2 – Business-to-consumer transactions

Company D provides digital content such as films (to view by streaming or to download), pictures and games to final consumers worldwide. Company D is established in Country A, where it has its offices and all the technical and human resources necessary to provide this content to its clients. Company D has no establishments abroad.

Clients in Country B download content provided by Company D from the Internet. Clients in Country B pay the service by credit card directly to the bank account of company D in Country A.

Questions

Where and how would you tax under GST/VAT the services supplied from Company D to final consumers in Country B taking into consideration the various phases mentioned below? Does the GST/VAT treatment differ and if yes, what would trigger such different treatment?

As the business develops, Company D implements the following models for delivery of its products

Phase 1

Content is downloaded by consumers in Country B from the servers of company D in Country A.

a) Where is the place of supply/taxation?

b) Who is liable to pay the GST/VAT and how?

Phase 2

As the number of consumers in Country B increases, Company D decides to rent a server in Country B from which clients can download the content provided by Company D. The server belongs to Company Z established and registered for GST/VAT in country B.

a) Does this change the place of taxation for the services supplied by Company D to consumers in country B?

b) Does this change the liability to pay the tax and the way the tax should be remitted to the tax authorities?

c) Where is the place of supply/taxation of the service made by Company Z (rent of server) to Company D?

d) Does the renting of the server in country B create a business/fixed establishment of Company D in Country B?

Phase 3

As trade with consumers in Country B develops further, Company D buys a server in Country B from which clients can download the content provided by Company D.

a) Does this change anything from a GST/VAT perspective compared to phase 2 above?

Phase 4

In addition to the property of the server, Company D contracts with a local service provider in Country B to maintain the server and respond to queries from clients. Does this change anything from a GST/VAT perspective compared to phase 2 and phase 3 above?

Phase 5

Rather than contracting with a local service provider, Company D has local employees to maintain the server and respond to queries from clients.

a) Does the local server owned by Company D in Country B and the local employees in Country B change the place of taxation for the services supplied by Company D to consumers in Country B?

b) Does this set up create a business/fixed establishment of Company D in Country B?

c) Does this change the liability to pay the GST/VAT and the way the tax should be remitted to the tax authorities?