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OECD INTERNATIONAL VAT/GST GUIDELINES
DRAFT COMMENTARY ON THE INTERNATIONAL VAT NEUTRALITY GUIDELINES

Invitation for comments

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Committee on Fiscal Affairs
Working Party N°9 on Consumption Taxes

IMPORTANT NOTICE

This discussion draft has been prepared as part of the work of the Working Party No. 9 on Consumption Taxes of the Committee on Fiscal Affairs on the International VAT/GST Guidelines, with significant input from its Technical Advisory Group (TAG) made up of academics and representatives from governments and business.

This document contains the draft of the Commentary on the International VAT Neutrality Guidelines that were approved by the Committee on Fiscal Affairs in June 2011 after public consultation (http://www.oecd.org/ctp/ct).

This draft Commentary should not be considered in isolation but as part of the OECD International VAT/GST Guidelines applicable to the cross-border trade in services and intangibles.

The attention of participants is drawn to the fact that this document reflects work in progress and that one or another country may not be in full agreement with one or more of its provisions. Nevertheless, the Committee on Fiscal Affairs believes that it will be extremely helpful to have input from all interested stakeholders. It should not be considered, at this stage, as final.

When commenting, we ask you to identify yourself as we may need to follow-up on your responses. Subject to prior authorisation by commentators, we may publish some of the contributions received on our Internet site.

Input can be provided by individuals or on a more collective basis by industry bodies or by professional advisory firms. Should you need further information please do not hesitate to contact Stéphane Buydens, Administrator, Consumption Taxes Unit (Stephane.Buydens@oecd.org).

Please send your comments ***by 26 September 2012*** either by

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INTERNATIONAL VAT/GST GUIDELINES

DRAFT COMMENTARY ON INTERNATIONAL VAT NEUTRALITY GUIDELINES: ACHIEVING NEUTRALITY IN PRACTICE

This is the Commentary on each of the six International VAT Neutrality Guidelines approved by the Committee on Fiscal Affairs of the OECD in July 2011. It provides further guidance on their application in an international context in practice.

It is important to bear in mind that the six International VAT[1] Neutrality Guidelines and their commentaries form a coherent whole and that they should not be read in isolation. In addition, they are to be read and understood in light of the International VAT/GST Guidelines more generally.

1. INTRODUCTION

1.1. OVERALL CONTEXT

1. This commentary on the International VAT Neutrality Guidelines is part of the OECD International VAT/GST Guidelines (the Guidelines), which are currently being developed by the Committee on Fiscal Affairs of the OECD[2]. The Guidelines provide rules for the application of VAT to cross-border trade. They are based on the destination principle, which provides that internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption. The Guidelines specify that, for internationally traded business-to-business supplies of services and intangibles, the application of this principle is, in most cases, best achieved by allocating the taxing rights to the jurisdiction in which the customer is located (the "Main Rule"). As a consequence of the Main Rule, such supplies are not taxed in the supplier's jurisdiction but are instead taxed on the same basis and with the same rates as local supplies in the jurisdiction of the customer (if VAT is applicable in that jurisdiction). The Guidelines recommend that the customer should be liable to account for any tax due through the reverse-charge mechanism where that is consistent with the overall design of the national consumption tax system.

2. In order to ensure the neutrality of the tax, the Guidelines also provide that businesses should in principle not bear the burden of VAT itself. In cross-border trade VAT neutrality is achieved relatively simply through the use of the Main Rule when the business customer that receives an imported service or intangible has a full right to deduct the input tax. In addition, even when the right to deduction of the business customer is limited, if that limitation is the same for imported services and intangibles as it would be for domestic supplies, neutrality may also be achieved.

[1] In the context of the OECD International VAT/GST Guidelines, the term "VAT" (for Value Added Tax) covers all taxes on consumption intended to be paid, ultimately, by final consumers and collected by businesses based on tax collection in a staged process, with successive businesses effectively paying tax only to the extent that the tax liability for (or value of) their outputs exceeds the tax on (or value of) all goods and services used as inputs for their business operations. VAT can be implemented in a variety of ways such as credit-invoice method, subtraction method or addition method. VAT can also be known under a variety of acronyms or names according to local traditions and languages. VAT is known under the acronym "GST" in a number of OECD countries.

[2] This work on VAT neutrality will not be fully completed before final agreement is reached on the Guidelines as a whole, in particular on the place of taxation rules.

3. However, it is recognised that the application of the Main Rule will not be possible in all situations. Under certain conditions, some supplies could be taxed in a jurisdiction other than that where the business customer is located. As a result, the foreign business customer may incur VAT in jurisdictions where it cannot recover the input tax by way of deduction through the same procedures as domestic businesses[3]. This may happen in situations where specific place of taxation rules are applied as an exception to the Main Rule. In such situations, alternative ways of ensuring neutrality should be available.

4. The overall neutrality of VAT on cross-border trade would be ensured by the application of the Main Rule to the widest extent possible and a consistent use of a limited number of specific place of taxation rules, together with a range of adequate relief mechanisms. However, in some instances, differences in the way two or more countries interpret place of taxation rules may create situations where neutrality is not achieved. This may also happen when businesses with no or limited right of deduction are involved. Further work may be needed to address such situations.

1.2. AIM OF THIS COMMENTARY

5. The aim of this Commentary is to provide guidance for the implementation of the International VAT Neutrality Guidelines in practice. The Guidelines are reproduced below.

Guideline 1
The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.

Guideline 2
Businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Guideline 3
VAT rules should be framed in such a way that they are not the primary influence on business decisions.

Guideline 4
With respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid.

Guideline 5
To ensure foreign businesses do not incur irrecoverable VAT, governments may choose from a number of approaches.

Guideline 6:
Where specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses.

6. For each guideline, there is a specific commentary that is intended to illustrate or provide further details on, but not change, its provisions. The International VAT Neutrality Guidelines and this Commentary form a coherent whole. In addition, they are to be read and understood in the light of the OECD International VAT/GST Guidelines more generally.

[3] A business is considered "domestic" in a jurisdiction when it is treated as such by the tax authorities of that jurisdiction. Any business that is not considered "domestic" in a jurisdiction is considered as a "foreign business" for the purpose of the OECD International VAT/GST Guidelines.

1.3. PRINCIPLES OF GOOD TAX ADMINISTRATION

7. The International VAT Neutrality Guidelines are not intended to interfere with the sovereignty of jurisdictions to apply tax rules for limiting the right to deduct input VAT or to establish specific administrative requirements for dealing with different categories of business (including foreign businesses). However, in order to ensure neutrality, governments are encouraged to apply the General Administrative Principles approved in 2001 by the OECD Forum on Tax Administration[4] (*GAP001 Principles of Good Tax Administration – Practice Note)*, which are reproduced in Box 1 below.

Box 1.

1. Guidance - Relations with Taxpayers - Revenue authorities *are encouraged to*:

1.1 apply tax laws in a fair, reliable and transparent manner;

1.2 outline and communicate to taxpayers their rights and obligations as well as the available complaint procedures and redress mechanisms;

1.3 consistently deliver quality information and treat inquiries, requests and appeals from taxpayers in an accurate and timely fashion;

1.4 provide an accessible and dependable information service on taxpayers rights and obligations with respect to the law;

1.5 ensure that compliance costs are kept at the minimum level necessary to achieve compliance with the tax laws;

1.6 where appropriate, give taxpayers opportunities to comment on changes to administrative policies and procedures;

1.7 use taxpayer information only to the extent permitted by law;

1.8 develop and maintain good working relationships with client groups and the wider community.

1.4. RECIPROCITY

8. According to the International VAT Neutrality Guidelines, foreign businesses should not be disadvantaged or advantaged compared to domestic businesses. This notably means that foreign businesses should not incur irrecoverable VAT when this would constitute an unjustified discrimination compared to domestic businesses. A number of approaches could be used for this purpose such as direct refunds to foreign businesses, refunds through a domestic registration procedure or making supplies VAT-free.

9. Some jurisdictions[5] require that the granting of refunds to foreign businesses be conditional upon similar relief being granted by the jurisdiction of the foreign business claimant. These requirements for reciprocity generally take two forms: the requirement for formal bilateral agreements between jurisdictions or unilateral decisions to recognise jurisdictions considered as having (or not having) appropriate features in their legislation.[6]

4 http://www.oecd.org/dataoecd/34/39/1907918.pdf

5 These include countries within the EU, as well as other countries.

6 Reciprocity is currently applied by some countries that operate "direct refund mechanisms" (i.e. refunds through a stand-alone procedure, rather than through a local registration). However, it is possible that it may be applied in a wider sense, in which case the same guidance in this commentary can also be applied**.**

10. Where jurisdictions adopt such requirements, reciprocity could only be applied between two countries that each has a VAT system.

11. The International VAT Neutrality Guidelines take no position on the desirability of jurisdictions adopting reciprocity requirements. However, insofar as jurisdictions choose to adopt such requirements, they should do so in a manner that minimises their impact on neutrality. Jurisdictions are therefore encouraged to treat other jurisdictions' mechanisms designed to ensure VAT-neutral treatment for foreign businesses as satisfying reciprocity requirements where these mechanisms achieve a substantially equivalent treatment. A substantially equivalent treatment might, for example, result from a mixture of VAT-free supply and local registration mechanisms as much as the application of a direct refund approach.

1.5. GROUPS OF COUNTRIES

12. Based on the principle set out in the *Guidelines on Consumption Taxation of Cross-Border Services and Intangible Property* (in the context of e-commerce) and in accordance with the Ottawa Taxation Framework Conditions, where specific measures are adopted by a group of countries bound by a common legal framework for their VAT system, such measures may apply to transactions between those countries. If this gives rise to a difference of treatment between member countries of such a group and non-member countries, and the treatment of non-member countries would not otherwise be inconsistent with the International VAT Neutrality Guidelines, that should not be regarded as being inconsistent with these Guidelines.

2. GUIDANCE

Guideline 1

The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.

Commentary

13. The aim of this Commentary is to provide further details on the neutrality principle expressed in Guideline 1. Although the focus of this Commentary is on Guideline 1, it is important to bear in mind that the International VAT Neutrality Guidelines (and the Commentary underpinning them) are intended to form a coherent whole. In addition, they are to be read and understood in the light of the International VAT/GST Guidelines more generally. So for example, in cases where Guideline 1 is met, it is still necessary to consider the other five International VAT Neutrality Guidelines in order to assess whether the neutrality principles are met.

14. VAT normally flows through businesses so that the final consumer, not the business, bears the burden of the tax. In domestic trade, VAT neutrality is achieved by the staged payment system: each (fully taxable) business pays VAT to its suppliers on its inputs and receives VAT from its customers on its outputs. Input VAT incurred by each business is offset against output VAT so that the amount of tax to be remitted to tax authorities by each business is the net amount or balance of those two. In some cases, the result of the offset gives rise to a refund due by the tax authorities to the business. Examples include businesses that incur more tax on their inputs than is due on their outputs (such as exporters, as their output is free of VAT under the destination principle) and businesses whose purchases are larger than their sales in the same period (such as with new or developing businesses or seasonality).

15. In cross-border trade, the neutrality of the tax is achieved by the application of the destination principle. According to this principle, exports are not subject to tax (free of VAT) and imports are taxed on the same basis and at the same rates as domestic supplies. This implies that the total tax paid in relation to a supply is determined by the rules applicable in the jurisdiction of its consumption and therefore all revenue accrues to the jurisdiction where the supply to the final customer occurs. In some instances, however, foreign businesses may incur VAT in jurisdictions where they cannot recover the input tax by way of deduction through the same procedures as domestic businesses (see paragraph 3 above). In the same way as for domestic businesses, foreign businesses should not bear the burden of the tax itself, except where provided for in legislation.

16. Although the burden of VAT should not fall on businesses, Guideline 1 recognises that governments may legitimately place a VAT burden on them when this is specifically set out in legislation. Guideline 1 and this corresponding Commentary do not seek to make any judgment about the circumstances in which it may or may not be appropriate to place a VAT burden on businesses. They simply recognise that governments may do so.

17. Guideline 1 is not intended to interfere with the sovereignty of jurisdictions to apply rules for limiting or blocking the right to deduct input VAT. However, in order to ensure neutrality, in applying such rules, tax administrations are encouraged to apply the principle of good tax administration as set out in Box 1 of the introduction to this Commentary.

18. The OECD Committee on Fiscal Affairs originally approved the implementation of the neutrality principle expressed in Guideline 1 in 2006. In this context, the CFA also explained what was meant by "except where explicitly provided for in legislation" by giving a number of illustrative, but not exhaustive examples. These are reproduced in paragraph 16 of the International VAT Neutrality Guidelines and include situations where:

- Transactions made by businesses are exempt because the tax base of the outputs is difficult to assess (i.e., many financial services) or for policy reasons (health care, education, culture).
- Full input tax recovery is not allowed owing to the nature of the related transactions. This could be the case when the business makes transactions that fall outside the scope of the tax (e.g., transactions without consideration) or the input tax relates to purchases that are not wholly used for furtherance of taxable business activity.
- Input tax blocks may be provided to balance the application of a lower VAT rate when goods can be either embedded in a product or bought separately at different rates.
- Input tax recovery is disallowed where explicit administrative obligations are not met (e.g., insufficient evidence to support input tax deduction).

19. When governments do impose a VAT burden on businesses, in accordance with Box 1 in the Introduction of this Commentary, legislation that so provides should be clear and transparent and should keep compliance costs to a minimum.

20. The reference to explicit provision in the legislation in Guideline 1 is not limited to provisions of the law itself but also includes explicit provision made under the law, such as in regulations or as a result of the exercise of administrative powers granted by the legislation. Decisions of courts of the relevant jurisdiction should also be taken into consideration.

21. When a tax burden is placed on businesses, the explicit provision for such burden in legislation does not suffice to make it consistent with the International VAT Neutrality Guidelines. It simply means that Guideline 1 is met. If the legislation in question does not meet the other five International VAT Neutrality Guidelines, or is inconsistent with the International VAT/GST Guidelines as a whole, such legislation cannot be seen as meeting the neutrality principles.

Guideline 2

Businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Commentary

22. The aim of this Commentary is to provide further details on the neutrality principle expressed in Guideline 2. Although the focus of this Commentary is on Guideline 2, it is important to bear in mind that the International VAT Neutrality Guidelines (and the Commentary underpinning them) are intended to form a coherent whole. In addition, they are to be read and understood in the light of the International VAT/GST Guidelines more generally. So for example, in cases where Guideline 2 is met, it is still necessary to consider the other five International VAT Neutrality Guidelines in order to assess whether the neutrality principles are met.

23. The main goal of Guideline 2 is to ensure that “similar levels of taxation” are achieved. However, the goal is recognised only with respect to “businesses in similar situations” that are carrying out “similar transactions”. If either one of these conditions is not satisfied, Guideline 2 has no application. Accordingly, in explaining the meaning of the Guideline, it is essential to separate the concepts of “businesses in similar situations” and “similar transactions.”

Similar levels of taxation

24. In the context of the International VAT Neutrality Guidelines, when determining whether a ”similar level of taxation” has been achieved, the final tax burden needs to be considered, taking into account all available refunds and credits. Businesses with full right to deduct input tax should not bear any tax burden, whether the services and intangibles they use to make their onward supplies are acquired abroad or on the domestic market. When a business without full right to deduct input tax incurs VAT in different jurisdictions, it should bear the burden of the VAT only once on each input. If such a business were to incur irrecoverable tax in two or more jurisdictions on the same input, it would not bear a “similar level of taxation” compared to another business without full right to deduct input tax which acquired its inputs solely within the domestic market.

25. Guideline 2 only applies to the VAT burden directly incurred by businesses. Guideline 2 does not cover situations where businesses indirectly incur a positive level of taxation for example where they acquire exempt services for which the supplier did not have a right to deduct its own input tax. In this case, the price paid by the business customer to its supplier may include embedded VAT that the supplier is unable to recover.

Businesses in similar situations

26. Determining whether businesses are in “similar situations” should be assessed with respect to their right of deduction, determined by the extent to which their inputs are used to support taxable activities (which give rise to the right to deduct the related input tax). A business that is acquiring services to support its taxable activities would not be in a “similar situation” to a business acquiring services to support its exempt activities or to one that acquires services predominantly for the personal use of its owners. For the avoidance of doubt, a “similar situation” should not be restricted to a comparison of similar industries.

27. The following are examples of businesses in similar situations, which are based on their right of deduction:

- A consulting company with a full right to deduct input tax in comparison to an airline company with a full right to deduct input tax.
- A bank that has a limited right to deduct input tax in comparison to an insurance company that has a limited right to deduct input tax.
- A consulting company with a full right to deduct input tax in comparison to a bank that also has a full right to deduct input tax (e.g. because it provides exported financial services only).
- A business with a limited right to deduct input tax, which acquires services for the private use of its owners, in comparison to a business which normally has a full right to deduct input tax and has acquired services for the private use of its owners.

28. The following are examples of businesses in dissimilar situations:

- A consulting company with a full right to deduct input tax in comparison to a bank that has a limited right to deduct input tax.
- A financial institution with a full right of deduction (e.g. because it provides exported financial services only) in comparison to a financial institution that has a limited right of deduction (e.g. because it provides exempt financial services to domestic customers).
- A business which normally has a full right to deduct input tax, and acquires services for the private use of its owners, in comparison to a business with a full right to deduct input tax which acquires services for use in its taxable activities.

Similar transactions

29. The determination of "similar transactions" for businesses "in similar situations" purchasing services or intangibles should focus on the characterisation of the particular services or intangibles being supplied. The way the supply is made, the person from whom it was acquired within the supply chain, or the terms under which the service or intangible was acquired should not be relevant to this determination.

30. The characterisation of a supply may not be consistent across jurisdictions. For example some jurisdictions may apply a specific tax treatment to a number of well defined services or intangibles while other jurisdictions have a single characterisation of services and then a single tax treatment for their supply. For that reason it is important to consider the characterisation of the supply under the rules in the jurisdiction in which businesses are being compared.

Summary

31. To summarise, the following factors are to be considered in determining when situations, transactions, and tax burdens, respectively, are similar.

- Businesses are in similar situations based on their use of the service or intangible and its related right to deduct input tax (i.e. the supply is used to further taxable activities, exempt activities or is for personal use - which will determine the right to deduct input tax).
- Businesses are carrying out similar transactions based on the characterisation of the supply under the rules in the jurisdiction in which the businesses are being compared.
- Business incur similar levels of taxation when they do not incur a tax burden, or when they do incur an irrecoverable direct VAT burden, it is only incurred once on the same supply, and that would also be the case for a business in a similar situation.

Guideline 3

VAT rules should be framed in such a way that they are not the primary influence on business decisions.

Commentary

32. The aim of this Commentary is to provide further details on the neutrality principle expressed in Guideline 3. Although the focus of this Commentary is on Guideline 3, it is important to bear in mind that the International VAT Neutrality Guidelines (and the related Commentary) are intended to form a coherent whole. In addition, they are to be read and understood in the light of the International VAT/GST Guidelines more generally. So for example, in cases where Guideline 3 is met, it is still necessary to consider the other five International VAT Neutrality Guidelines in order to assess whether the neutrality principles are met.

33. Inconsistency with Guideline 3 relating to the impact of VAT on business decisions is probably reflective of an inconsistency with one of the other Guidelines. Where this is the case, businesses may try to restructure their supply chain or operations to try to achieve the neutrality that does not otherwise exist.

34. For example, in situations where foreign businesses are advantaged compared to domestic businesses, in respect of the level of taxation (which is inconsistent with Guideline 4), a foreign business may change the decision it would otherwise make primarily[7] to take advantage of this treatment. Thus, a business may decide to operate from offshore rather than in the domestic jurisdiction.

35. When evaluating a jurisdiction where a domestic business can fully recover local VAT, a foreign business that would not be eligible for VAT recovery, refund or relief may decide, primarily based on the VAT burden, that it will not undertake activities (sales, purchases, or related activities such as production or support services) in that jurisdiction or that it has to restructure the supply chain to achieve the neutrality that does not otherwise exist.

36. In order to assess the consistency of the VAT rules with Guideline 3, the business decisions that are relevant would be those relating to cross-border operations, which may be impacted by the VAT legislation, such as:

- whether a business will decide to operate in a jurisdiction;
- whether a business will sell to customers in a jurisdiction;
- whether a business will make purchases from a vendor located in a jurisdiction;
- whether a business outsources activities such as production, manufacturing or other support services to be carried out in a jurisdiction, and
- how a business structures its supply chain or makes use of intermediaries.

[7] In their paragraphs 18 and 19, International VAT Neutrality Guidelines adopted in June 2011 recognise that "*a number of factors [...] can influence business decisions, including financial, commercial, social, environmental and legal factors. Whilst VAT is also a factor that is likely to be considered, it should not be the primary driver for business decisions. For example, VAT rules or policies should not induce businesses to adopt specific legal forms under which they operate (e.g. whether in a subsidiary or a branch structure). [...] VAT considerations include the amount of tax ultimately paid to tax administrations, the compliance burdens related to the collection, payment or refund of the tax such as filing of tax returns, maintaining adequate book-keeping and the financial costs related to the cash-flow impact of the VAT system*.

37. By contrast, business decisions that are not relevant would be those relating to the domestic operations, such as:

- decisions not to purchase or sell items on which there is a block on input tax credits (e.g. in some jurisdictions there is a difference between leased and purchased items);
- altering products or services to take advantage of a different tax status (e.g. taxable at a positive rate, exempt or zero-rated); and
- taking advantage of simplified methods of calculating taxes due, which may be available to smaller suppliers.

Guideline 4

With respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid.

Commentary

38. The aim of this Commentary is to provide further details on the neutrality principle expressed in Guideline 4. Although the focus of this Commentary is on Guideline 4, it is important to bear in mind that the International VAT Neutrality Guidelines (and the Commentary underpinning them) are intended to form a coherent whole. In addition, they are to be read and understood in the light of the International VAT/GST Guidelines more generally. So for example, in cases where Guideline 4 is met, it is still necessary to consider the other five International VAT Neutrality Guidelines in order to assess whether the neutrality principles are met.

39. Guideline 2 deals with equity of treatment for businesses in similar situations carrying out similar transactions. Guideline 4 deals with equity of treatment for foreign businesses relative to domestic businesses in a jurisdiction where foreign businesses may otherwise bear a VAT burden, which would not apply to domestic businesses or vice-versa.

40. In the context of the International VAT Neutrality Guidelines and with respect to the level of VAT incurred, “foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid” should be understood to mean that:

- There should not be any discriminatory application of the rules simply because a business is foreign;
- Foreign businesses should not end up having a tax advantage compared to domestic businesses in terms of their final tax burden; and
- If Guideline 4 is followed, VAT should not distort competition between foreign and domestic businesses.

41. This Guideline deals with the ultimate application of VAT on businesses. Foreign businesses should not be subject to irrecoverable VAT compared to domestic businesses, however that outcome is achieved, e.g. through application of zero-rate rules, refund mechanisms, etc. Nor would the creation of a tax advantage, in terms of the final tax burden, for foreign businesses compared to domestic businesses acting in similar circumstances be consistent with this Guideline. When legislation provides a refund or other form of relief mechanism to foreign businesses, in such a way that they are not advantaged or disadvantaged compared to domestic businesses, Guideline 4 is met.

Guideline 5

To ensure foreign businesses do not incur irrecoverable VAT, governments may choose from a number of approaches

Commentary

42. The aim of this Commentary is to provide further details on the neutrality principle expressed in Guideline 5. Although the focus of this Commentary is on Guideline 5, it is important to bear in mind that the International VAT Neutrality Guidelines (and the Commentary underpinning them) are intended to form a coherent whole. In addition, they are to be read and understood in the light of the International VAT/GST Guidelines more generally. So for example, in cases where Guideline 5 is met, it is still necessary to consider the other five International VAT Neutrality Guidelines in order to assess whether the neutrality principles are met.

43. A range of approaches could be used to ensure that foreign businesses do not incur irrecoverable VAT. These include (but are not limited to):

- making supplies free of VAT;
- allowing foreign businesses to obtain a refund through a specific regime;
- allowing foreign businesses to obtain a refund through local VAT registration;
- shifting the responsibility to locally registered suppliers/customers[8]; and
- granting purchase exemption certificates[9].

44. Each approach seeks to ensure that foreign businesses do not incur irrecoverable VAT. None of the approaches is to be preferred over the others. It is likely that each approach will have its merits in particular circumstances, as each seeks to strike a balance between the relative compliance costs for businesses (both local supplier and foreign customer) on the one hand and administrative costs and the risks of tax fraud and avoidance for the tax authorities on the other. Countries may prefer to apply a mix of different approaches depending on the nature of the supplies involved. For example, for some supplies, making supplies VAT free may be preferred to direct refunds or registration because it removes the compliance costs for businesses of having to claim the VAT back. For other supplies, a refund or registration system may be preferred because of the difficulty faced by the supplier in determining the status and location of the customer.

[8] Some countries provide for a shift in responsibilities to allow either a) a purchaser to claim input tax that was charged to a non-resident vendor who is not registered for local VAT, or b) services to be provided on a VAT-free basis to a non-resident who is not registered, even though the services may closely-relate to property that is located in the local country, when the property that the services relate to will be subsequently delivered to a registrant in the local country.

[9] Some countries allow a non-resident purchaser who may or may not be registered locally to provide a purchase exemption certificate to allow the supplier to make a supply on a VAT-free basis. The supplier would be responsible for retaining a copy of the purchase exemption certificate on file to substantiate why tax was not charged to the non-resident.

45. Governments will seek to protect their tax bases from fraud and to use all reasonable methods to achieve this objective. However, cost effectiveness is important to any mechanism for achieving neutrality, including any refund and similar schemes. Measures taken by a government to protect its tax base may therefore need to be balanced with the objective of keeping compliance and administration costs as low as possible.

46. For example, a direct refund system that applies a *de minimis* threshold before refund applications are accepted would meet the neutrality objective provided that the threshold is reasonable and reflects the balance between the administration costs of processing the refund and the amount of VAT involved. On the other hand, a registration system that does not allow refunds unless taxable supplies are made in the local jurisdiction by the non-resident business may not adequately meet the neutrality objective.

Guideline 6

Where specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses.

Commentary

47. The aim of this Commentary is to provide further details on the neutrality principle expressed in Guideline 6. Although the focus of this Commentary is on Guideline 6, it is important to bear in mind that the International VAT Neutrality Guidelines (and the Commentary underpinning them) are intended to form a coherent whole. In addition, they are to be read and understood in the light of the International VAT/GST Guidelines more generally. So for example, in cases where Guideline 6 is met, it is still necessary to consider the other five International VAT Neutrality Guidelines in order to assess whether the neutrality principles are met.

48. Domestic businesses and foreign businesses have different characteristics, which may be taken into account by tax administrations. Domestic businesses will generally have a fixed place of business from where the business is operated, local employees and contact persons, a local bank, local links to the tax authorities and various forms of identification / registration through bodies such as local Chamber of Commerce and Trade Registry. On the other hand, foreign businesses are less likely to have a legal presence, local staff or links with the local community.

49. It is this lack of presence and history in a jurisdiction that inevitably brings an element of risk for tax administrations, for which appropriate measures may need to be taken to protect against fraud and avoidance[10]. Specific compliance requirements may therefore be needed if the standard requirements applicable to domestic businesses do not provide adequate protection for governments. Tax administrations are also encouraged to take full advantage of available instruments that support exchange of information and mutual assistance in debt recovery (e.g. the Joint Council of Europe/OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters).

50. In addition, where jurisdictions operate a relief mechanism specifically aimed at foreign businesses, they may also have specific rules and requirements for that mechanism.

51. The International VAT Neutrality Guidelines recognise that the administrative requirements for domestic and foreign businesses may not be identical. However, if jurisdictions choose to adopt specific rules and requirements on foreign businesses, they should do so in a manner that minimises their impact on neutrality.

52. In essence, where there is an element of additional compliance burden associated with doing business in a foreign jurisdiction, the burden created by the specific administrative requirement or requirements should not be disproportionate or inappropriate.

53. A requirement or combination of requirements may be disproportionate or inappropriate when it is out of proportion with the situation it relates to or does not achieve a relevant purpose when assessed and measured against the objective it is aiming to achieve.

54. An appropriate balance is needed between the perceived benefits of a specific requirement or combination of requirements and the need to prevent unjustified discrimination. In other words, specific rules or practices (e.g. audits) applicable to foreign businesses should not result in a disguised form of discrimination and should also meet the guiding principles set out in paragraph 7 of the introduction to this Commentary.

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[10] Further work should be undertaken regarding fraud and avoidance issues.

55. For example, if a tax administration requires a bank guarantee, the amount and duration should not be disproportionate to the amount claimed. Similarly, when documentation is required to support a refund claim (possibly in the language of the country where the claim is lodged), it should be limited to the documents that are necessary to the assessment of the validity of the claim.

56. Tax administrations will also incur administrative costs in managing specific relief mechanisms aimed at foreign businesses (e.g. a refund mechanism). When they set up *de minimis* thresholds, they should not effectively prevent the use of the mechanism.

57. Whilst the concept of specific administrative requirements for foreign businesses is generally understood to mean additional and more complex requirements, it is not always the case. In some instances, tax administrations can set up a simplified compliance system specifically for foreign businesses. Examples include specific zero-rating provisions applicable to supplies to foreign businesses, as well as simplified registration and reporting procedures for foreign businesses.

58. Finally, specific administrative requirements or simplifications adopted by a group of countries that is bound by a common legal framework for their consumption tax systems may differ from those applicable to businesses from other countries. As expressed in paragraph 12 of the introduction to the Commentary such a difference of treatment should not be regarded as being inconsistent with Guideline 6.

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ANNEX

YOUR CONTACT INFORMATION

Contact for follow-up:

Name:

Organisation:

Country:

E-mail address:

Telephone:

Fax:

Please indicate whether you are responding to this questionnaire :

- ☐ As an academic or student
- ☐ As a corporate taxpayer
- ☐ On behalf of other taxpayer(s) (e.g. advisory firm, law firm, business association, etc.)
- ☐ Other (please specify)

Where you are replying on behalf of others please construe the term "you" to mean "your organisation" or "your clients" as appropriate.

Do you authorize the OECD to publish your contribution on our internet site?

- ☐ Yes
- ☐ No