THE IMPACT OF GST AND VAT ON CROSS-BORDER TRANSACTIONS

Rebecca Millar*

1. Background[1]

Cross-border consumption tax issues have become increasingly topical in recent years. Value added taxes spread rapidly in the last quarter of the 20th Century and into the current century. The first primitive VAT was introduced in France shortly after the Second World War and thereafter VAT got off to a relatively slow start, with only 21 countries having a VAT by 1975,[2] but thereafter it spread increasingly rapidly until by the beginning of 2006 there were reputedly more than 140 countries with some form of value added-type consumption tax.[3]

During the period when VAT was still in its infancy, the international community had begun addressing the income tax conflicts that arise when two countries claim the right to tax the same income. The first elements of what is now the OECD Model Tax Convention were published at virtually the same time that European nations were first experimenting with VAT.[4] The proliferation of double tax treaties (DTAs) after 1958 paralleled and to some extent pre-dated the proliferation of VATs, which at least partly explains why DTAs are almost exclusively concerned with income tax conflicts and do not address indirect consumption taxes.[5] VAT has often been lauded (perhaps naïvely) as a simple, self-collecting tax, which could provide a solution to the problems inherent in collecting income taxes. But now that VAT has spread so widely, that naïveté is beginning to dissipate with the realisation that VATs pose their own sets of problems, not the least of which are the same kinds of cross-border conflicts that arise for income taxes. In an increasingly globalised world, and one in which the rapid development of telecommunications technology and greater ease in travelling have changed the way in which people do business, cross-border "services" transactions have become the particular focus of VAT lawyers and policy makers alike. The

* Senior Lecturer, Sydney Law School, University of Sydney. Ms Millar also works with the Australian Taxation Office, the IMF, and the World Bank, and has drafted VAT and excise tax laws for a number of countries. She is currently one of two academic members of the Technical Advisory Group assisting the OECD's Working Party No. 9 to develop guidelines for GST and VAT cross-border services rules.

1 I would like to thank Christophe Waerzeggers, Utrecht School of Law, Universiteit Utrecht, for his feedback on this paper and for his insights on the EC VAT Directive and its embodiment in the Belgian BTW/TVA. Any mistakes are nonetheless entirely of my own making. My thanks also to Professor Richard Vann, Sydney Law School, who was kind enough to provide feedback on one of the later drafts. Throughout this paper, the acronyms VAT (for 'Value Added Tax') and GST (mostly commonly standing for 'Goods and Services Tax') are used interchangeably . In addition, terminology applicable to the law being discussed is used. Where Australian terminology is used, the more common terminology used in other jurisdictions sometimes appears immediately thereafter in brackets for the benefit of non-Australian readers. In brief, the equivalences of the terms are as follows: "enterprise," "connected with Australia," "input taxed," and "GST-free" (used in Australian GST law) = "economic activity," "place of supply," "exempt without credit," and "exempt with credit" (European VAT Directive) = "taxable activity," "place of supply," "exempt," and "zero-rated" (New Zealand).

2 International Tax Dialogue, *The Value Added: Tax Experiences and Issues,* a Background Paper prepared for the International Tax Dialogue Conference on VAT, Rome, March 15–16, 2005, pp.7-10.

3 Bird R & Gendron P, *The VAT in Developing and Transitional Countries*, (2007) Cambridge University Press, Cambridge, at p.16.

4 Organisation for European Economic Cooperation, *The Elimination of Double Taxation, Report of the Fiscal Committee of the Organisation for European Economic Cooperation* (OEEC, 1958, Paris).

5 N.P. Eriksen, 'Should Tax Treaties Play a Role for Consumption Taxes?' 33 *Intertax*, Issue 4, p.166.

current work being undertaken by the OECD and the recent changes to the EC VAT Directive, both of which are discussed in this paper, are examples of this new concern.[6]

While there are obvious parallels between the double tax problems of income tax and the cross-border issues that arise for VAT, it can be deceiving to take the parallels too far. In income tax, the classic divide is between countries that tax on a residence basis (taxing the worldwide income of their residents from whatever source) and those that tax on a source basis (taxing anyone, whether resident or not, on income that has its source in the relevant jurisdiction). The objective of tax treaties is to agree which country will be entitled to tax which income, and as a result some types of income are commonly taxed on a source basis (e.g. active business income), while others are commonly taxed on a residence basis (e.g. interest income), and if residents of a country that taxes on a residence basis receive income that has been taxed at source in another country, the residence country may provide some form of relief from double taxation (through foreign tax credits, exemption, or deduction).[7]

At first glance, the consumption tax issues look similar: there is a conflict between the origin principle (which appears intuitively analogous to source) and the destination principle (which appears intuitively analogous to residence).[8] The main reason why the analogy breaks down is because it is almost universally agreed that VATs should be implemented according to the destination principle,[9] so that the main reason why there are conflicts is not because countries are using competing jurisdictional principles, but because they have different ways of implementing the principle of choice. To complicate matters, a false appearance of disagreement can arise when the origin principle is used as a means to implement the destination principle. Nonetheless, to the extent that income tax conflicts arise when more than one country claims to be the source of income, similar issues can arise if two countries claim to be the destination of goods or services.

This paper commences by explaining the principles on which the jurisdictional reach of a GST/VAT is determined and the use of proxies to determine the place of taxation (Section 2). It then outlines the different ways in which those principles are given effect in the legal design of various countries' laws, focussing on the treatment of services under the current European Model,[10] the new European Model,[11] and the New Zealand model,[12] and

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6 Although cross-border services rules are currently the primary focus of concern, it would be a mistake to think there are no conflicts in cross-border issues relating to goods. European Community Member States, in particular the United Kingdom, have experienced significant problems with carousel fraud (Missing Trader fraud), a form of VAT evasion that takes advantage of cross-border rules to increase the chances of successfully evading VAT without detection. The United Kingdom estimated that in the 2005-06 financial year, the level of attempted Missing Trader fraud was £3.5-£4.75 billion (some of which was discovered, so that the estimate of actual revenue lost was £2-£3 billion): *The Comptroller and Auditor General's Standard Report on the Accounts of HM Revenue & Customs 2006-07*, page R55, para 5.6. In principle, carousel fraud could also arise with services, though to date the focus of concern has mainly been on goods.

7 OECD Committee on Fiscal Affairs, *Model Tax Convention on Income and Capital*, (2005, OECD, Paris), electronic version.

8 These principles are explained in Section 2.1 of this Paper.

9 L Ebrill, M Keen, J-P Bodin, & V Summers, *The Modern VAT*, (2001, IMF, Washington DC), Chapter 17. See also: OECD, Centre for Tax Policy and Administration, *International VAT/GST Guidelines* (2006, OECD, Paris), at para 4 of the Preface.

10 As embodied in *Council Directive of 28 November 2006 on the Common System of value added tax, 2006/112/EC [2006] OJ L 347/1* (the EC VAT Directive), which consolidates the amended version of *Sixth Council Directive of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment 77/388/EEC, OJ 1977 L 145/1* (the Sixth Directive).

placing the Australian model[13] within the landscape created by those models (Section 3). The paper then looks at some of the conflicts that can arise, and the causes and effects of those conflicts (Section 4). Finally, it outlines the current work being undertaken by the OECD to develop guidelines for applying GST/VAT to cross-border services transactions and analyses how the three models fit with the emerging ideals (Section 5).

The paper concludes that, viewed in the light of the emerging consensus, the Australian GST is over-inclusive of non-residents and needs to be modified to take a more practical approach by using the reverse charge mechanism for supplies by non-resident suppliers who are not established in Australia. In addition, it relies too heavily on a general application of proxies and will inevitably need to move to a greater subdivision of rules to apply specific proxies to particular types of supply.

2. Theory and Practice

The essential features of a GST are described in the following statement of the European Court of Justice (ECJ), which has been cited with approval by Australian Courts describing the Australian GST:

> " VAT applies generally to transactions relating to goods or services; it is proportional to the price of those goods or services; it is charged at each stage of the production and distribution process; and finally it is imposed on the added value of goods and services, since the tax payable on a transaction is calculated after deducting the tax paid on the previous transaction."[14]

Although its objective is to tax final private consumption, GST is imposed as a transaction tax payable by suppliers of goods or services. The tax is indirect, both because it taxes transactions in lieu of directly taxing consumption, and because it collects the tax from suppliers rather than from consumers. In form, it is a value added tax, because each person (supplier) who contributes to the production and distribution of goods or services for final consumption pays tax on its outputs, after subtracting the tax it has incurred on its inputs.

This means that a jurisdictional rule is required for all types of transaction, including both business to business (B2B) and business to consumer (B2C) transactions, while at the same time an overall jurisdictional principle must govern the way in which the rules for particular transactions give effect to the intended aim of taxing final private consumption.

The rules governing the jurisdiction to tax transactions are commonly referred to as *place of taxation* rules or (particularly in the European Union) *place of supply* rules. The overall jurisdictional principles to which these place of taxation rules must give effect are the *destination* and *origin* principles.

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11 As embodied in *Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services, 2008 O.J.(L 44) 11.*

12 As embodied in the *Goods and Services Tax Act 1985* (the GST Act 1985 (NZ)).

13 As embodied in *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act 1999 (Aus)).

14 *Dansk Denkavit ApS v. Skatteministeriet* [1994] 2 CMLR 377 at p. 395, cited by Hill J in his judgments in the Full Federal Court decisions *ACP Publishing Pty Limited (ABN 18 054 605 640) v Commissioner of Taxation* [2005] FCAFC 57 and *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126.

2.1 The destination and origin principles

In deciding where a transaction (a *supply* of goods or services) should be taxed, there are two possible jurisdictional principles that can be applied: the *origin principle* and the *destination principle*. Under the origin principle, tax is applied in the country *from which* the supply is made, while under the destination principle, a supply is taxed in the country *to which* the supply is made.[15]

Under the origin principle:

- internal (domestic) transactions are taxed;
- imports are GST-free (zero-rated);[16] and
- exports are taxed.[17]

Thus, the tax paid on goods or services supplied for private consumption equals the sum of the value added in each country that contributed to the production, distribution, and supply of the goods or services, multiplied by the VAT/GST rate applicable in each such country. In addition, the total tax revenue collected is distributed to each of the relevant countries in proportion to the value added therein.[18]

In contrast, under the destination principle:

- internal (domestic) transactions are taxed;
- imports are taxed;[19] and
- exports are GST-free (zero-rated).

Thus, the tax payable on goods or services supplied for private consumption is determined by the VAT/GST rate applicable in the country in which the goods or services are consumed, and all of the consumption tax revenue for those goods or services accrues to that country.[20]

While economists posit that the two principles are in theory equivalent, provided that an appropriate exchange rate adjustment is made,[21] in practice the equivalence is virtually impossible to achieve unless each country has a broadly similar GST/VAT to that of its

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15 Inland Revenue (NZ), Policy Advice Division, *GST: A Review, A Government Discussion Document*, (March 199, IRD, Wellington), at paras 1.15, 9.3, and 20.40. See also: R Millar, 'Jurisdictional Reach of VAT', in R. Krever (ed.) *VAT in Africa* Pretoria University Law Press (PULP) (2008) 175–214, available as *Sydney Law School Research Paper No. 08/64* at http://ssrn.com/abstract=1162510.

16 Imports are GST-free because no GST is applied at the point of import. However, because any subsequent value added locally is taxed, the import value must be excluded from the tax base of subsequent transactions, which necessitates giving a deemed input tax credit for the import .

17 GST is charged on the supply of goods or services with a domestic origin, whether or not the goods are exported, and a foreign purchaser is not entitled to an input tax credit or refund.

18 Ebrill et al, above note 9, at pp.176-177.

19 The need to tax imports means that GST must operate as both a tax on transactions and a tax on imports because imports can occur independently of transactions, both for goods and services. For example, goods can be imported by a person who already owns them. Similarly, the local branch of a foreign company might benefit from intellectual property acquired through the head office and it might be appropriate to treat this as an import of services.

20 Ebrill et al, above note 3, at p.176.

21 Inland Revenue (NZ), Policy Advice Division, *GST and Imported Services – a challenge in an electronic commerce environment; A Government Discussion Document* (June 2001, IRD, Wellington), para 4.11 at p.19. See also Ebrill et al, above note 3, at page 180.

trading partners and the balance of trade between them is roughly equal.[22] In addition, and probably more telling, there are pragmatic arguments against using the origin principle, as noted in the following extract from the New Zealand Inland Revenue:

> " A GST based on the origin principle seems to have advantages … It means, for example, that there is no need to tax imported services (or any other imports), removing the need to tax supplies (such as digitised products) that are not easily taxed as they cross the border.
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> Nevertheless, a GST system based on the origin principle has serious administrative problems. Imports would need to remain zero-rated through to final consumption. To achieve this, a deemed input tax credit would need to be provided to registered persons first acquiring imported supplies. This would create an unacceptably high risk to the tax base. In addition, since the essential equivalence of goods and services taxation based on the origin and destination principles is often misunderstood, the origin approach, which on its face appears to disadvantage New Zealand businesses, is unlikely to be widely accepted as trade neutral."[23]

As a result of these kinds of concerns, there is almost universal acceptance that the destination principle is the ideal to which GST/VAT laws should aspire.[24] Indeed, in discussing the significant variations in both the tax base and legal design between VATs (including amongst the VATs of the European Community Member States), Bird and Gendron note that one of the key areas in which all VATs are fundamentally similar is in their adherence to the destination principle.[25]

In keeping with this international consensus, the Australian GST is based on the destination principle. This is made clear in the opening words of the Executive Summary of the Explanatory Memorandum (EM) to the Bill that introduced GST:

> " The GST is a broad based indirect tax introduced by the Government to replace the wholesale sales tax and a number of State indirect taxes. Broadly speaking, the GST is a tax on private consumption in Australia. The GST taxes the consumption of most goods, services and anything else in Australia, including things that are imported. Generally the GST will not apply to consumption outside Australia, which is why the GST does not apply to exports."[26]

Thus, as noted, consumption tax conflicts arise in an environment where most countries agree on the underlying jurisdictional principle. What is not agreed is the way in which that principle should be implemented because, of course, it is all very well to say that supplies must be taxed in the place *to which* they are supplied, but it is still necessary to agree on where that place is. The key source of conflicts, and the focus of current debate, is the design and interpretation of the *place of taxation* rules that implement the destination principle.

In theory, under a perfectly designed set of place of taxation rules, for any particular transaction: *place of taxation = place of destination = place of consumption*.[27] At the same time, in a particular country, the overall effect of the application of the place of taxation rules to all

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22 Inland Revenue (NZ), Policy Advice Division, *GST: A Review; A Government Discussion Document*, (March 1999, IRD, Wellington), para 20.41 at p.110. See also Ebrill et al, above note 3, at page 180-183.

23 Inland Revenue (NZ), above note 21, paras 4.12 & 4.13 at page 19.

24 see above note 9.

25 Bird & Gendron, above note 3, at p.15. The second fundamental similarity noted by Bird & Gendron is the operation of VAT/GST as a transaction tax, a feature noted already.

26 Explanatory Memorandum to the *A New Tax System (Goods and Services Tax) Bill 1998* (the GST Bill), Chapter 1, Executive Summary, opening words.

27 R Millar, above note 15.

transactions should be to tax all domestic consumption in accordance with that country's rules and not to tax in that country any consumption that takes place elsewhere.

2.2 Concepts of consumption

Before looking in more detail at place of taxation rules, a comment on concepts of consumption must be made. Since GST/VAT is charged on all transactions, place of taxation rules are required for both B2B and B2C transactions, even though the aim is not to collect tax on the B2B transactions, but to have it flow through the business chain until its final burden falls on the consumer in a B2C transaction. This requires a GST/VAT law to have a legal concept of consumption for both B2B and B2C supplies, even though from an economic point of view the notion of consumption with which the tax is concerned is a B2C concept.

From a B2C perspective, GST is not so much concerned with the *actual consumption* or *use* of goods or services as with *consumption expenditure* (the price paid to acquire goods or services for the purpose of consuming them, whether immediately or in the future). This can be variously seen in the following comments about VAT:

> " Economists generally [favour] designing the VAT so that it is a tax on consumption, in the sense that its key effect is to drive a wedge between the price that consumers pay for their purchases and the price that suppliers receive from the corresponding sales."[28]

> " The principle of the common system of value added tax entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services…"[29]

> " Ultimately VAT is a tax on consumption expenditures as they are incurred. Although the taxation of transactions may not be a goal in itself (as it would be under, say, a stamp duty), it is sufficiently central to the nature of the VAT that it cannot be ignored."[30]

What these statements have in common is their focus on the price paid for goods and services. GST/VAT taxes consumption expenditure at the time of supply or import on the presumption that the expenditure represents the net present value of the future consumption of the goods or services supplied or imported.[31]

If the payment of a price were the only concern, the VAT concept of consumption for place of taxation purposes could be identical for both B2B and B2C supplies. But there is a complication when it comes to B2B supplies: whatever the economic realities, VAT laws are written on the presumption that VAT flows through the business chain towards its inevitable object, the consumer. This is true for all businesses, including unregistered businesses and those making input taxed (exempt) supplies, who while they cannot claim input tax credits, are presumed to pass on the cost of their input tax in the price of their outputs. This was described by the late Justice Graham Hill in the following passage:

> " If it be necessary here to state a general policy for the application of the GST to enterprises making input taxed supplies, it would be that, to the extent that an entity carries on an enterprise

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28 Ebrill et al, above note 3, at page 15 under the heading "VAT as a Tax on Consumption."

29 EC VAT Directive, Article 1(2).

30 Cnossen S, "VAT Treatment of Immoveable Property" in V Thuronyi (ed) *Tax Law Design and Drafting* Vol 1 (1996, IMF, Washington DC) 231 at p.234.

31 Cnossen, ibid at pp.233-234.

> that consists of making input taxed supplies, it will bear the GST on acquisitions without an input tax credit so that its pricing of outputs, if any are made, will take into account, commercially, all GST it will be required to bear on its inputs."[32]

Although describing the flow-through effect for input taxed supplies, his Honour's comments are equally applicable for taxable supplies. So far as VAT is concerned, the inputs of a business are 'cost elements' of the outputs of the business (the 'cost element' principle). Whereas, in a B2C transaction, it is presumed that the customer (the recipient of the supply) will completely consume the goods or services supplied (*i.e.* use them up until they exist no more), in a B2B supply, it is presumed that the goods supplied will become cost elements of subsequent supplies to the recipient's own customers. Businesses are not consumers, and the place of taxation rules must take account of this to ensure that the burden of one country's GST/VAT does not flow through into the price of another country's consumption.

2.3 The use of proxies to determine place of consumption

As noted, while the objective of GST/VAT is to tax the use of goods or services, in its legal design it is a tax on consumption expenditures. One consequence of this transactional focus is that GST/VAT is equivalent to a retail sales tax, since it is paid and refunded continuously along the chain of production and distribution, with no tax revenue being collected until the end point, where the relevant end point is a B2C transaction.[33] This means that the place of taxation for a B2C supply must be determined at the time of the supply on the basis of a prediction about where the customer is likely to consume the goods or services supplied. For a B2B transaction, on the other hand, the place of taxation rule must recognise the cost element principle, so that the place of taxation must in some way relate to the likely place of taxation of the subsequent transactions the business customer will make.

Rather than simply saying 'the place of taxation is the place of consumption,' VAT laws use *proxies* as a way of controlling these predictions. The main reason for using proxies is that a pure consumption test is simply too unmanageable in practice because it opens up the possibility of conflicting views as to where the place of consumption will be. If neither the taxpayer nor the tax administrator is given any guidance about how to identify the place of consumption, there is no way of ensuring consistency. What is likely to happen in practice is that each person applying such a rule will look to features of the transaction to predict the place of consumption, with no guarantee that people will consistently choose the same features for the same transactions.

From a legal design perspective, greater certainty is achieved if the legislator specifies which features of the transaction (proxies) should be used to determine the place of taxation for particular types of supply. This reduces the scope for disputes between taxpayers and revenue authorities. At the same time, it provides a language with which countries can discuss the question of which of them should have jurisdiction to collect GST on particular transactions.

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32 *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126, para 50.

33 Cnossen, above note 31, at p.232. See also Graeme Cooper "The Discrete Charm of the VAT" *Sydney Law School Research Paper No. 07/65* Social Science Research Network, www.ssrn.com. A B2C transaction can include a supply to a quasi-consumer, by which is meant a person who, while carrying on an enterprise and therefore in theory part of the chain of production and distribution, is not registered for GST or, though registered, is not entitled to claim an input tax credit for its inputs because it is making input taxed (exempt without credit) supplies. It also includes out of scope entities, such as Government. Whether transactions with quasi-consumers should be treated as B2B or B2C in cross-border rules is itself a matter for debate and the appropriate response might be different for different types of entity.

It is not surprising, then, that the OECD recommends that place of taxation rules for services should use proxies, rather a pure consumption test, on the basis that the latter is impractical and inappropriate.[34]

This recommendation creates an interesting counterpoint to the Australian Treasury's current preference for principle-based drafting in Taxation Laws.[35] The OECD's work, which aims to develop a common understanding of what the destination principle means and how it should be effected in the legal design of VAT/GST laws, highlights the tensions created by principle-based drafting and it may be that, in its approach to cross-border services, the Australian GST law turns out to be too principle-based to provide the level of certainty required by businesses.[36]

2.4 Tangible and intangible proxies

The proxies used to predict the place of consumption in a GST/VAT are commonly described as being *tangible* or *intangible*. Tangible proxies are those that relate to physical objects such as goods or land, while intangible proxies are those that relate to persons. Obviously, since persons are themselves tangible, and since the objective of using proxies is to connect transactions with a particular place, all proxies could be said to be tangible. But the essential distinction being made is between a person involved in the transaction (supplier, recipient, or third party) and some physical object other than a person. More than one proxy may be applied in an iterative process to determine the place of taxation for a particular transaction, with both tangible and intangible proxies being applied before the final decision is made.

The main tangible proxies are:

(i) the location of goods;
(ii) the location of land;
(iii) the place of performance.

The main intangible proxies are:

(i) the location, residence, or place of business of the supplier;
(ii) the location, residence, or place of business of the recipient;

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34 Committee on Fiscal Affairs Working Party N°9 on Consumption Taxes, *Applying VAT/GST to Cross-Border Trade in Services and Intangibles: Emerging Concepts for Defining Place of Taxation: Invitation for comments*, (January 2008, OECD, Paris) (the First Consultation Paper), para 4 at p.4.

35 See Parliament of Australia, Joint Committee of Public Accounts and Audit, *Inquiry Reviewing a Range of Taxation Issues within Australia*, Submission by the Australian Treasury (April 2006) and Supplementary Submission by the Australian Treasury (November 2006) (submissions 51 and 51.1, both of which are available at http://www.aph.gov.au/house/committee/jpaa/taxation06/subs.htm).

36 Of course, the Australian Taxation Office has attempted to reduce the uncertainties by issuing an extensive body of rulings on the jurisdictional coverage of Australia's GST, some of which are noted in this paper. As of 4 August 2008, the consolidated versions of the rulings focussing on international issues covered some 769 pages, of which 543 pages dealt with the single section of the law (GST Act 1999, s.38-190) that covers the GST-free treatment of 'exported services'. Moreover, international issues are also covered in rulings focussed on other topics (notably, the rulings on financial services, agency relationships, foreign currency conversions, schemes to abuse the second-hand goods rules). That the Commissioner found it necessary to write so much on this topic, and that in what is written he frequently attempts to break down the application of the general principles into more specific rules for particular types of supply, confirms the points being made in this paper.

(iii) the place of supply of a related supply;
(iv) the location, residence, or place of business of a person (other than the recipient) to whom the supplied is provided/rendered/delivered, or by whom it is received;
(v) the place of effective use or enjoyment of the supply.

Whether a *place of effective use or enjoyment* rule is in fact a proxy depends on how it is applied. In some cases, it is interpreted as an invitation to apply further proxies and it is rare to find it interpreted as a pure place of consumption test (i.e. focussing on the actual place of use in a particular transaction).[37] In keeping with this tendency the Commissioner of Taxation treats place of effective use or enjoyment as a proxy for the *location of the person to whom the supply is provided*, whether that be the recipient or a third party.[38] This treats the place of effective use or enjoyment rule as a way of combining the second and fourth of the intangible proxies. It also confirms the point made earlier, that when faced with what looks like a *place of consumption* rule, the response of taxpayers and revenue authorities alike will be to look to features of the transaction as proxies for predicting where consumption/effective use or enjoyment is likely to take place.

2.4.a. The use of tangible proxies

It should be unsurprising that tangible proxies are used when the subject matter of the supply (the 'thing' supplied) is tangible, for example, for a supply of the ownership or use of goods or land.

EXAMPLE – AN EXPORT OF GOODS: The following discussion focuses on the simple example of a sale of goods that are exported from Country A to Country B in the course of the supply.

ITERATIVE APPLICATION - TANGIBLE PROXIES: One design option is to have the place of taxation rules of Countries A and B apply as follows:

Step 1: The *origin of the goods* (their location before the transaction) is Country A, therefore the supply is 'made in' or 'connected with' Country A;

Step 2: The *destination of the goods* (their location as a result of the transaction) is Country B because they are exported, therefore Country A will treat the supply as zero-rated/GST-free/exempt with credit;

Step 3: The goods are *imported into* Country B (their destination), and so Country B has the right to tax the import (or to choose not to).

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37 Many of the VATs of Anglophone African nations use a general place of consumption or place of effective use or enjoyment rule for zero-rating services. However, such countries generally apply these by expanding on them in regulations which use proxies for the place of consumption, or by treating the *place of effective use or enjoyment* as a proxy for the *customer location* proxy. See R Millar, above note 15. The Rwanda VAT, on the other hand, uses a place of effective use or enjoyment to impose tax on supplies by non-residents: *Law No.06/2001 of 20/01/2001 on the Code of Value Added Tax* (Rwanda), Article 9(d) provides that services have their place of supply in Rwanda if the supplier "has no place of business in Rwanda, has [a] place of business elsewhere but the recipient of the services uses or obtains the benefit of the services in Rwanda" but this is presumably interpreted by reference to the location and/or residence of the customer since the tax is reverse charged to the customer: Articles 28(2)(b) and 29(2).

38 GSTR 2007/2 *Goods and Services Tax: In the application of paragraph (b) of item 3 in the table in subsection 38-190(1) of the A New Tax System (Goods and Services Tax) Act 1999 to a supply, when does 'effective use or enjoyment' of the supply 'take place outside Australia'?*

Thus, Country A's place of taxation rules, consisting of a place of supply rule and a zero-rating rule, operate to ensure that the supply is not taxed in Country A because it is presumed that the goods will be consumed at their destination. At the same time, Country B's place of taxation rules include a tax on imports, which ensures that tax is applied (if at all) at that destination.

This approach corresponds to the way in which proxies are combined to determine place of taxation for a sale of goods in both the Australian GST and, to the extent that it deals with transactions from a European Community (EC) supplier to a non-EC recipient, the European VAT. In other situations, the European VAT sometimes short-circuits the iterative approach by using the *place of supply* rule to determine the place of taxation directly, without the need for zero-rating.[39]

ITERATIVE APPLICATION - MIXED PROXIES: An alternative design is adopted by countries following the New Zealand model, which achieve the same end result using a different first step:

Step 1: The *supplier's residence* or the *place of performance* is Country A, therefore the supply is 'made in' Country A.

Here an intangible proxy can determine *place of supply*, despite the fact that the subject matter of the supply is tangible. However, the *place of taxation* is still determined by a tangible proxy, which over-rides the intangible proxy either in Step 1 (if *place of performance* applies) or in Step 2 (which zero-rates the export). The intangible proxy is used on the presumption that resident suppliers will mostly make supplies to resident customers, but is overridden when they do not.

Tangible proxies are also used for supplies of ownership of or the right to use land. Though land itself has the advantage of not moving, the rights over and in relation to land that are the subject matter of supplies can be traded across borders, and it is important for place of taxation rules to capture all such transactions. This can be achieved by broadly defining a supply of land,[40] or by having specific rules for particular types of such supply, each one using the location of the land, or a proxy for the location of the land, to determine place of taxation.[41]

Tangible proxies can also be used for supplies of *things other than goods or real property*,[42] which most countries refer to as *services*. The *location of goods* and *location of land* proxies are used for services that are in some way connected with goods or land, or connected with supplies of goods or land. Exactly what level of connection is required varies from one VAT law to another. Physical performance on goods or land is generally considered a relevant connection, as is effecting a change in the ownership of the goods or land, but as the level of connection moves away from these close connections, there is as yet no common agreement on where

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39 EC VAT Directive, Articles 31-42.

40 As in Australia, where 'real property' is defined for GST purposes far more widely than its common law meaning: see definition in s.195-1, *Saga Holidays Ltd v FCT* [2006] FCAFC 191, and *Commissioner of Taxation v Reliance Carpet Co Pty Limited* [2008] HCA 22.

41 For example, the new European place of supply rules will use the location of land as a proxy for the place of supply of specified types of supply of land, all of which would be covered by the single rubric 'real property' in Australia: see below at Section 3.1.b of this Paper.

42 This is the terminology used in GST Act 1999 (Aus), ss.9-25(5) and 38-190.

the connection with the physical world becomes irrelevant and the use of an intangible proxy becomes more appropriate.[43] The way in which the proxies are applied also varies. European model countries tend to specify the services to which tangible proxies apply, whereas New Zealand model countries (including Australia) tend to specify the underlying principle (the level of connection required).

The *place of performance* proxy can also be used for supplies of services. In general, it is used for services for which there is some underlying expectation that consumption will take place at the time and place where the services are performed. As with the use of the other tangible proxies for services, European model countries tend to specify the services to which place of performance applies, whereas New Zealand model countries tend to state the principle underlying the use of the proxy in more general terms. Thus, for example, the EC VAT Directive uses place of performance as a proxy for, amongst many others, supplies of cultural, sporting, scientific, educational, and entertainment activities.[44] In contrast, New Zealand applies a *general* place of performance rule for all supplies by a resident to a non-resident, which are zero-rated if the place of performance is outside New Zealand,[45] but applies a more *limited* place of performance rule to a supply reverse charged from a non-resident to a resident, which can be zero-rated when performed outside New Zealand only if "the nature of the services is such that the services can be physically received at no time and place other than the time and place at which the services are physically performed."[46]

This is an example of a proxy being applied (the *physical receipt of the performance* of the services) with such generality and breadth that it is more analogous to principle-based drafting than to the OECD recommended proxy-based approach. Clearly, the question of what is a service that can only be received "at no time and place other than the time and place at which the services are physically performed" is one on which taxpayers and the New Zealand Inland Revenue will at some point disagree. The principle may well be one that underlay the choice of services for which place of performance would be used as a proxy in the European model, but the Europeans thought it better to have the legislator apply the principle. On the other hand, the European approach has its own downsides. It leaves open the possibility that services which should be taxed at the place of performance have been left out of the list, and it changes the point of focus for disputes from the meaning of the proxy to the characterisation of the supply, so that questions such as "Is this a supply of entertainment?" must be answered.

2.4.b. The use of intangible proxies

As noted, intangible proxies rely on features of the entities involved in the transaction (supplier, recipient, or a person receiving the thing supplied) or on the place of supply of a related supply. Intangible proxies tend to be used to determine the place of taxation for services, though as noted already, they are sometimes also used as one step in the process of determining the place of taxation for goods or land.

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43 See, for example, the discussion of differing approaches to real estate agents services between Australia, New Zealand, South Africa, and the United Kingdom in R Millar, 'Sources of Conflict in Cross-Border Services Rules for VAT' (2008) *Sydney Law School Research Paper No. 08/14*, available at http://ssrn.com/abstract=1068542.

44 EC VAT Directive, Article 52.

45 GST Act 1985 (NZ), s.11A(1)(j).

46 GST Act 1985 (NZ), s.11A(1B).

Unlike supplies of goods, which are essentially treated similarly in most GST/VAT laws, there is considerable divergence in the place of taxation rules for services.

EXAMPLE - EXPORTED SERVICES: The following discussion focuses on the simple example of a supply of services performed in Country A by a supplier who is located and resident in Country A and who supplies the services to a recipient who is located and resident in Country B. There is no third party involvement and the services are intangible, in that they have no connection with goods or land and are not necessarily consumed where they are performed.

ITERATIVE APPLICATION OF PROXIES: One design option is to use the same iterative approach applied to goods, so that the place of taxation rules of the two countries apply as follows:

Step 1: The *location/residence of the supplier* (and/or the *place of performance* of the services) is Country A, therefore the supply is 'made in' Country A (connected with Australia);

Step 2: The *location/residence of the recipient* is Country B (the services are 'exported'), therefore Country A will zero-rate the supply (GST-free);

Step 3: The services are *supplied into* Country B (their destination), and so Country B may:

(a) treat the services as having been imported by the recipient and reverse charge the GST (i.e. require the recipient to charge itself GST);

(b) suspend the right to tax by not applying the reverse charge if the recipient would be entitled to claim back through input tax credits all/most of the tax charged;

(c) treat the supply of the services as a taxable supply in Country B and require the Country A supplier to register for GST in B;

(d) chose not to tax the supply on the basis that it is too hard to collect.

Thus, Country A's place of taxation rules, consisting of a place of supply rule and a zero-rating rule, operate to ensure that the 'exported services' are not taxed in Country A because it is presumed that they will be taxed in the country of their destination. At the same time, Country B's place of taxation rules operate to ensure that tax is applied (if at all) at the destination of the services. This outline corresponds to the design of the Australian GST and to most countries following the New Zealand model, other than New Zealand itself, for which this design applies for resident suppliers but not for non-resident suppliers.[47]

CATEGORISATION APPROACH: In contrast, countries following the European model concatenate the rules into a single place of taxation rule that is embodied in the place of supply rule. Rather than an iterative application of proxies, the approach to determining the place of taxation of the simple example looks something like this:

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47 Countries following the New Zealand model without the variation for non-residents include South Africa, Singapore, Botswana, and Barbados. Some Caribbean countries (Belize, Antigua and Barbuda, and Saint Vincent and the Grenadines) adopt the full New Zealand model, so that this iterative approach applies only to supplies by residents.

Step1A Is this a category S service? If yes, the supply is made in Country A because the *location/residence of the supplier* is Country A.

Step1B Is this a category C service? If yes, the supply is treated as being made in Country B because the *location/residence of the recipient* is Country B.

Step 2A: If the supply is B2B, Country B may:

(a) reverse charge VAT to the recipient;

(b) suspend the right to tax if the recipient would be entitled to full input tax credits;

Step 2B: If the supply is B2C, Country B may:

(a) treat the supply of the services as a taxable supply in Country B and require the Country A supplier to register for GST in B;

(b) chose not to tax the supply on the basis that it is too hard to collect.

Here, rather than applying proxies in an iterative approach from Step 1 through to Step 3, services are divided into categories and those in Category S are taxed under Step 1A on an origin basis (at the supplier's location) while those in Category C are taxed under Step 1B on a destination basis (at the customer's location). This means that some 'exported services' are taxed on an origin basis, but countries using this design generally try to minimise the extent to which this occurs by categorising services that are likely to be traded across-borders into Category C (which uses customer location), leaving the supplier's location to be used as a proxy for domestically traded services and services in the 'too hard' basket. In more complex examples, there are, of course, more Step 1 levels, which apply on either an origin or a destination basis for other categories of services such as tangible services and 'arranging for' services. Thus, there will also be Category L supplies (for which the *location of land* proxy applies), Category G supplies (for which the *location of goods* proxy applies), Category P supplies (for which the *place of performance* proxy applies), Category R (for which the *place of supply of a related supply* proxy applies), and countless other categories using other minor proxies and/or proxies for proxies.

Under this categorisation approach, if the place of taxation is determined by *customer location*, Step 1B requires a further subdivision of the transactions into B2B (for which VAT can only be applied using the reverse charge mechanism) and B2C (for which the non-resident supplier can be required to register). It is in this respect that the New Zealand model mixes the two designs: while primarily following the iterative approach, for supplies by non-residents into New Zealand it applies these two sub-steps, reverse charging B2B supplies to recipients who could not credit 95% of the input tax, and requiring registration for B2C supplies, but only if they are performed in New Zealand.[48]

The range of options open to Country B under both the iterative approach and the categorisation approach illustrates the difficulties of taxing supplies by non-residents who have no local establishment. Reverse charging is an option, but is difficult to enforce when the recipients are end consumers. Requiring the supplier to register for B2C supplies relies on

48 See Section 3.2 of this paper.

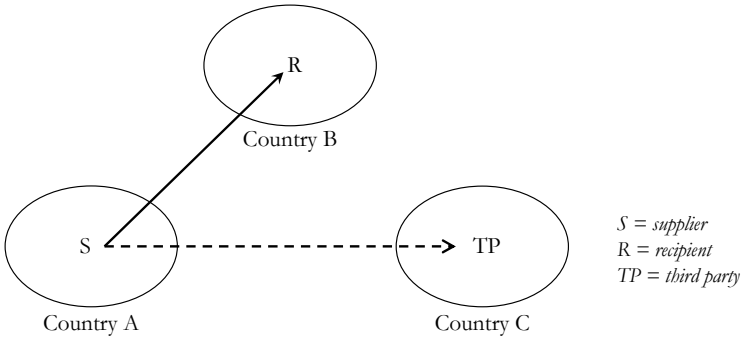
voluntary compliance by non-residents, and non-compliance will result in the services being effectively GST-free.[49]

2.4.c. Who consumes? Cross-border Grandma's Flowers

With the example of an export of goods, the location of the recipient was considered irrelevant: goods were presumed to be consumed where they were located and so the involvement of third parties was irrelevant. But the presumption for services is that they are consumed where the person consuming them is located, so when a supplier *supplies* services to the recipient of a supply by *providing* them to a third party, a question arises as to whose location most accurately predicts the place of consumption and should be used as the proxy for determining place of taxation.

This can be illustrated using a cross-border *Grandma's flowers'* transaction (named after an example used in the Australian GST rulings in which a grandson orders flowers from a florist for direct delivery to his grandmother).[50]

Diagram 1: Cross-border Grandma's flowers



Goods: Grandson (the recipient in Country B) orders flowers from a florist S (the supplier in Country A) to be sent to his grandmother TP (the third party in Country C) for her birthday. Because the transaction is a supply of goods, most countries agree on the appropriate treatment: the supply is an export of goods from Country A to Country C and so it is GST-free/zero-rated in Country A and taxable (if at all) on import to Country C.

Services: If, instead of flowers, the transaction involves a supply of services, where should tax apply? If the grandson requests the supplier to deliver a singing telegram to his grandmother, which proxy should determine the place of taxation? There are three parties, each located in and resident in different countries. The *place of performance* is Country C (unless the telegram is sung over the phone from Country A). The recipient grandson, who is *resident and located* in Country B, is *paying for* the services from Country B and is *enjoying the benefit* of the services in Country B, because they fulfil his need to acknowledge his grandmother's birthday.

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49 Of course the tax can then be collected from the resident customer under a rule making the supplier and recipient jointly liable for the tax, but this is tantamount to reverting to a reverse charge option but with the distinct disadvantage that the customer might be required to pay an amount to the supplier to cover its GST/VAT liability and then be required to pay the same amount to the revenue authorities, thus subjecting the customer to double tax because of the revenue authority's inability to collect.

50 Australian Taxation Office, Goods and Services Tax Ruling *GSTR 2006/9: Goods and services tax: supplies*, paras 118-122, 130, and 149.

The third party grandmother who is *resident and located* in Country C is also *enjoying the benefit* of receiving the services, because she is *receiving their performance* in Country C and literally *consuming* them by hearing the telegram be sung.

While a cross-border Grandma's flowers example might seem artificial (why, for example, would the grandson not choose a supplier in Country C?) and raise the spectre of further supplies (has the supplier in fact subcontracted the provision of the goods or services to a person in Country C?), it nonetheless nicely illustrates the difficulties that arise in practice when deciding where services should be taxed.

Further complexity is added when the recipient and/or the third party are businesses rather than end consumers, because the place of taxation rules must then take account of the cost element principle, making sure that GST/VAT from each country does not cascade into the prices of subsequent supplies in the other countries.

An increasing number of countries following the New Zealand model have specific exceptions to their exported services rules, which prevent zero-rating/GST-free treatment of services that are supplied to a non-resident but provided to/received by a resident. While New Zealand applies the rule only when the entity to which the services are provided is an end consumer,[51] Australia applies it more generally, including when all three parties are registered for GST/VAT in their country of establishment/residence.[52]

2.4.d. Tangible and intangible services

The OECD also classifies services as tangible or intangible, a distinction based on the proxies used to determine place of taxation.[53] Thus, a *tangible service* is a service for which the place of taxation is determined by reference to a *tangible proxy*, whereas an *intangible service* is one for which the place of taxation is determined by reference to an *intangible proxy*. While the classification of services as tangible and intangible is a useful analytical tool, it does not provide a great deal of assistance in the process of trying to reach international agreement on place of taxation rules because the questions are circular: For which type of service should we use a tangible proxy? For a tangible service. What is a tangible service? A service for which we should use a tangible proxy.

In its current work on place of taxation rules for services (see Section 5) the OECD will need to develop common understandings of where and how particular types of supply are consumed in order to agree on which proxies to use. An agreement about when to use tangible proxies for services will be one outcome of this work. Such an agreement will inevitably involve deciding to what extent tangible proxies should be applied by using the European categorisation approach (specifying the types of service to which each proxy applies) or by using the New Zealand principles-based approach (specifying the general principle underlying the proxy, such as the level of necessary connection with goods/land). It

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51 GST Act 1985 (NZ), s.11A(2). See also: *Antigua and Barbuda Sales Tax Act 2005*, Schedule 2, paragraph (3); *General Sales Tax Act 2005* (Belize), Second Schedule, paragraph (4); *Value Added Tax Act 2006* (Saint Vincent and the Grenadines), Schedule 2, paragraph (3).

52 GST Act 1999 (Aus), s.38-190(3). Singapore also has such limitations built into its zero-rating rules for services because it requires that the supply to a person outside Singapore must directly benefit a person outside Singapore: *Goods and Services Tax Act Cap 117A* (Singapore), s.21(3)(j), (k), and (s).

53 OECD, *Taxation and Electronic Commerce Implementing the Ottawa Taxation Framework Conditions* (2001, OECD, Paris) at pp.24-25.

seems highly likely that that outcomes of the current work will include a reasonable level of categorisation, with agreed classifications of services that should be covered by each tangible proxy and the general principles either being reserved for use in determining which "other similar services" should also be covered by those proxies, or being included in an explanation of the classifications. Any service not classified as tangible, and not brought in by extrapolation using the principle underlying the proxy, will be intangible. This categorisation approach is intuitively more attractive because it seems to promise a greater level of certainty, though it is by no means certain that this is in fact the case.[54]

3. Ways of implementing the destination principle

This section of the paper briefly outlines the way in which existing GST/VAT laws incorporate the principles discussed above, focussing in particular on the way in which proxies are combined to achieve taxation on the basis of the destination principle. The European Model and the New Zealand model are described first, because they represent the two extremes, both in terms of the starting point for determining place of taxation and the order in which proxies are applied. These models are then compared with the Australian model, which is a hybrid between them but which also moves away from both in its approach to non-resident suppliers. The discussion focuses on the main rules for cross-border services, since most GST/VAT laws use the destination of goods to determine their place of taxation. The treatment of international transport and hiring of means of transport are also excluded.

As noted, under all models, the *place of taxation rules* include place of supply rules, zero-rating rules, and a tax on imports. The terminology used in Australia is different ('connection with Australia' for 'place of supply' and 'GST-free' for 'zero-rated') but the purpose and effect of the rules is the same.

3.1 The European Model

3.1.a. Place of taxation for services – the current rules

The EC VAT Directive uses the categorisation approach to determine the place of taxation for services through its place of supply rules.

(1) The *location of land* is used for:[55]

- Services connected with land, including the services of estate agents, architects and firms providing on-site supervision.

(2) The *place of performance* is used for:[56]

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54 This prediction is purely the author's own opinion. It is based on two observations. First, the sheer number of OECD members that are also EC Member States must inevitably influence the decision-making process. Even though the consultation documents eschew preconceived approaches based on existing laws, the thinking processes each country brings to its understanding of VAT inevitably remains. Secondly, as noted, even countries that specify proxies in general terms have a tendency to interpret the rules by using at least some degree of sub-classification of services, and may also introduce more specific rules over time (this has been the case in New Zealand, as any observation of the introduction dates for various parts of GST Act 1985, ss.11 & 11A will reveal).

55 EC VAT Directive, Article 45.

- Cultural, artistic, sporting, scientific, educational, entertainment or similar activities, including the activities of the organisers of such activities.
- Ancillary services; ancillary transport services.
- Valuations of and work on goods.[57]

(3) The location of a related supply is used for:[58]

- Most services of agents, but this rule applies mainly to B2C transactions.

(4) The *customer location* is used for:[59]

- Electronically supplied services supplied by a non-resident to a non-taxable person in the EC.[60]
- B2B and B2C supplies to customers outside the Community and B2B supplies between Member States of the following services (the Article 56 Services):[61]
  - specified intellectual property rights.
  - advertising.
  - the services of consultants, engineers, lawyers, accountants and other similar services, plus data processing and supplies of information.
  - restraints of trade.
  - financial services and insurance.
  - supplies of staff.
  - the hiring of goods (other than means of transport).
  - access to gas and electricity distribution systems.
  - telecommunications services and radio and TV broadcasting.
  - electronically supplied services.
  - the services of agents who take part in the supply of the services.

  When supplied to a customer outside the Community, these services are effectively zero-rated.[62]

(5) The location of the supplier is used for:[63]

- Any supply not covered by another rule.

(6) The place of effective use or enjoyment is used for:

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56 EC VAT Directive, Article 52.

57 Not including B2B supplies within the Community, if the goods are removed from the country in which the services were performed: EC VAT Directive, Article 55.

58 EC VAT Directive, Article 44, which does not apply to intra-Community B2B transactions, certain transport-related supplies, and certain supplies to customers outside the Community. Thus, it mainly applies to B2C transactions.

59 The location of the customer is the place of business or fixed establishment to which the supply is made, or in the absence of such a place, the customer's permanent address or usual residence: EC VAT Directive, Article 56.

60 EC VAT Directive, Article 57.

61 EC VAT Directive, Article 56.

62 EC VAT Directive, Article 169(a).

63 EC VAT Directive, Article 43. The location of the supplier is the place of business or fixed establishment from which the supply is made, or in the absence of such a place, the permanent address or usual residence of the supplier.

- B2C telecommunications services supplied into the EC by a non-resident.[64]
- At the option of the Member State and for the purpose of avoiding double taxation or non-taxation, or distortion of competition, the Article 56 services (not including electronically supplied services).[65]

Clearly, under these rules, there will be times when European VAT is incurred by customers consuming the services outside the EC. Where the customer is a business, a refund might be available,[66] but this option will not always be available. Even within the EC, the fact that the *location of the supplier* is a fallback proxy for all supplies for which no special rule applies, means that it is possible for VAT to be applied in the Member State of origin rather than the Member State of consumption. It is for these reasons that the place of supply rules for services will be progressively replaced from 1 January 2009.

3.1.b. Place of taxation for services – the new rules

In response to the increasing trade in cross-border services, the European Community has adopted new place of taxation rules for services, which will be phased in between 2009 and 2015. The basic principles the new rules intend to apply are set out in the recitals at the beginning of the Council Directive by which they were introduced:[67]

- in principle, the place of taxation should be the *place of consumption*;[68]
- for B2B supplies, the primary proxy should be the *customer location*;[69]
- for B2C supplies, the primary proxy should be the *location of the supplier*;[70]
- exceptions to the general rules, for B2B and/or B2C, should reflect the basic principle of taxation at the *place of consumption*, but should not place a disproportionate administrative burden on businesses.[71]

These principles are given effect in new *place of supply* rules, which consist of two *main* rules and a number of *particular* rules. By 2015, the use of proxies in the new rules will be as follows. (As before, the rules for transport are omitted.)

(1) The *customer location* will be used as the main rule for:

- B2B supplies.[72]

64 EC VAT Directive, Article 59(1).
65 EC VAT Directive, Articles 58 & 59.
66 For non-EC customers, refunds might be available under the Thirteenth VAT Directive: 13th Council Directive 86/560/EEC of 17 November 1986 on the harmonization of the laws of the Member States relating to turnover tax arrangements for the refund of value-added tax to taxable persons not established in Community territory, O.J L 326, 21.11.1986, p. 40–41. For EC customers incurring VAT in another member state than their member state of registration, refunds might be available under the Eighth VAT Directive: 8th Council Directive 79/1072/EEC of 6 December 1979 on the harmonization of the laws of the Member States relating to turnover taxes - Arrangements for the refund of value added tax to taxable persons not established in the territory of the country, O.J L 331, 27.12.1979, p. 11–19
67 Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services, 2008 O.J.(L 44) 11.
68 ibid, paragraph (3) of the preamble.
69 ibid, paragraph (4) of the preamble.
70 ibid, paragraph (5) of the preamble.
71 ibid, paragraph (5) of the preamble.
72 Above note 67, Article 2, amending the EC VAT Directive from 1 January 2010 (new Article 44).

It will also be used as a particular rule for:

- specified B2C supplies to non-EC customers (the Article 59 services, being a subset of the current Article 56 services).[73]
- telecommunications services, radio and television broadcasting services, and electronically supplied services.[74]

(2) The *location of the supplier* will be used as the main rule for:

- B2C supplies.[75]

(3) The *location of land* will be used as a particular rule for B2B and B2C supplies of:[76]

- services connected with land, including the services of experts and estate agents.
- the provision of hotel accommodation and similar supplies (holiday camps, camping sites, etc).
- grants of rights to use land.
- services of preparation for and co-ordination of construction work.
- services of architects and on-site supervision.

(4) The *place of performance* will be used as a particular rule for:

- B2B supplies of admission to cultural, artistic, sporting, scientific, educational, entertainment or similar activities such as fairs and exhibitions, and ancillary services.[77]
- B2C supplies of services (including ancillary services) relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities such as fairs and exhibitions, and the services of organising such activities.[78]
- B2B and B2C supplies of valuations of and work on goods;[79] and restaurant and catering services, other than those carried out on ships, aircraft, or trains.[80]

(5) The *place of departure* will be used as a particular rule for:

- B2B and B2C restaurant and catering services, carried out on ships, aircraft, or trains.[81]

(6) The *place of supply of a related supply* will be used as a particular rule for:

- B2C agency services.[82]

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73 ibid (new Article 59). The major changes from Article 56 to Article 59 are (a) the removal of agency services from the list as of 2010 and (b) the removal of telecommunications, broadcasting, and electronic services from the list as of 2015.
74 Above note 67, Article 5, amending the EC VAT Directive from 1 January 2015 (new Article 58).
75 ibid (new Article 44).
76 ibid (new Article 47).
77 Above note 67, Article 3, amending the EC VAT Directive with effect from 1 January 2011 (new Article 53).
78 ibid (new Article 54(1)).
79 ibid (new Article 54(2)).
80 above, note 67 (new Article 55).
81 above, note 67 (new Article 57).
82 above, note 67 (new Article 46).

(7) The *place of effective use or enjoyment* will be available (at the option of the Member State and for the purpose of avoiding double taxation or non-taxation, or distortion of competition) for use as a general over-ride to:[83]

- the supplier location proxy used:
  - in the main B2C rule.
- the customer location proxy used:
  - in the main B2B rule.
  - for the Article 59 services.
  - for radio and TV broadcasting, and electronic services.
  - for telecommunications services.[84]

These new rules are only marginally less complex than the existing rules, but they do herald a significant move towards treating the customer location as the main proxy for determining the place of consumption, particularly for B2B supplies. Where exceptions apply, it is primarily for services that the EC considers to be tangible (as evidenced by the use of tangible proxies). Only *intangible* intra-Community B2C services (other than telecommunications, radio and TV broadcasting, and electronically supplied services) remain taxed at the supplier's location, either because there is an expectation that the customer will be co-located with the supplier, or because any other option is too hard. Presumably, the services included in Article 59, which are effectively zero-rated when supplied B2C to non-EC customers, are services that are able to be supplied remotely and for which the presumption of co-location will not always hold true. When such services are supplied between Member States within the EC the place of taxation will not necessarily be the place of consumption.

3.1.c. Reverse charge mechanism

Under the European model, reverse charging is applied to simplify collection. In a B2B supply of services where the supplier and recipient are located in different countries, the VAT liability is reversed and it is the recipient that must pay any VAT due.[85] For reverse charging to apply, the supply must be a taxable supply, which means that the place of supply must be in the country where the recipient is located. Thus, the place of supply rule establishes the place of taxation, while the reverse charge rule merely deals with liability and collection.

83 above, note 67 (new Article 59a).

84 But not if the supplier has opted to use the special regime for telecommunications that will operate from 1 January 2015.

85 EC VAT Directive, Articles 195-199.

3.2 The New Zealand Model

As noted, the New Zealand model uses the iterative approach in the design of its cross-border services rules, with a significant variation for services supplied into New Zealand by non-residents. Thus, both the place of supply and zero-rating rules contribute to determining the place of taxation.

3.2.a. Place of supply in New Zealand GST

The place of supply rules are essentially origin-based.

(1) If the supplier is *resident* in New Zealand, the place of supply is New Zealand;[86]

This uses an *intangible proxy* as the starting point, but once the zero-rating rules are considered, it is clear that this intangible, origin-based proxy is only used as the final proxy for determining place of taxation for transactions where consumption is in fact highly likely to occur New Zealand. In other words, the *residence of the supplier* is used as a proxy for the *customer location*, which is the destination of the services.

(2) If the supplier is a *non-resident*, the place of supply is determined according to an *in-out-in-out* analysis, applied in the following order:

Out: The supply is not made in New Zealand because the supplier is a non-resident.[87] However:

In: The supply *is* made in New Zealand because the services are physically performed in New Zealand.[88] However:

Out: The supply is *not* made in New Zealand if the recipient is a registered person,[89] unless:

In: The supplier and recipient have agreed as much in writing.[90]

This uses an *intangible proxy* (the residence of the supplier) and a *tangible proxy* (the place of performance) as the starting point for determining place of taxation. Again, the *residence* of the supplier is used as a *proxy for a proxy*, on the presumption that the supplier and recipient will be co-located in the same jurisdiction. However, *non-residence* is not an appropriate proxy when the supply actually occurs in New Zealand, which is why the *place of performance* proxy over-rides the *residence* proxy for B2C supplies and, at the option of the parties to the transaction, for B2B supplies.

In addition, special rules apply for telecommunications services supplied by non-residents, other than supplies between telecommunications suppliers.[91] Such supplies are treated as 'made in' New Zealand if they are *initiated* by a *person who is physically in New*

86 GST Act 1985 (NZ), s 8(2).
87 ibid.
88 GST Act 1985 (NZ), s 8(3).
89 GST Act 1985 (NZ), s 8(4).
90 ibid.
91 GST Act 1985 (NZ), s.8(7).

Zealand.[92] A telecommunications supply is initiated by the person appearing highest on the following list:[93]

- the person who controls the commencement of the supply;
- the person who pays for the services;
- the person who contracts for the supply.

The *initiation* proxy is both intangible and tangible. It is intangible because it focuses on the *location of the person* initiating the supply, who is essentially the person consuming the supply. It is also tangible, because it focuses on one aspect of the *place of performance* (the place at which the connection commences).

3.2.b. Zero-rating of exported services

The *place of taxation* for services is determined under the New Zealand model through a combination of *zero-rating rules* for exported services and the taxing rules for *imported services* (the reverse charge rules).[94] The proxies used to determine place of taxation are as follows.

(1) The *location of land* is used as a proxy for services supplied directly in connection with:

- land *outside* New Zealand.[95]
- land *in* New Zealand.[96]

(2) The *location of goods* is used as a proxy for services supplied directly in connection with:

- goods *outside* New Zealand when the services are performed[97]
- goods *in* New Zealand when the services are performed.[98]
- goods *temporarily in* New Zealand, which are taxed according to their destination after the services are performed.[99]

(3) The *location and residence of the recipient* (a non-resident outside New Zealand when the services are performed)[100] are used as proxies for:

(a) on their own:

- services to overseas postal organisations for delivery in New Zealand of postal articles mailed outside New Zealand.[101]
- specified intellectual property rights, know-how, confidential information, trade secrets, and similar rights.[102]

92 GST Act 1985 (NZ), s.8(6). See also s.8A for limitations on the rule where it is impractical to apply it.
93 GST Act 1985 (NZ), s.8(9).
94 GST Act 1985 (NZ), s.8(4B) & (4C).
95 GST Act 1985 (NZ), s. 11A(1)(e).
96 Such services cannot be zero-rated: GST Act 1985 (NZ), s. 11A(1)(k)(i)(A)
97 GST Act 1985 (NZ), s.11A(1)(f).
98 Such services cannot be zero-rated: GST Act 1985 (NZ), s. 11A(1)(k)(i)(B)
99 GST Act 1985 (NZ), s.11A(1)(i) and to the extent that is applies to ship/aircraft stores, s.11A(1)(h).
100 GST Act 1985 (NZ), ss.11A(1)(k), (l), (m), (ma), & 11A(4B).
101 GST Act 1985 (NZ), s.11A(1)(g). In this case, there is no specific requirement that the overseas postal organisation be outside New Zealand, but in most cases it will be.
102 GST Act 1985 (NZ), ss.11A(1)(n) & 11A(4)(b).

- telecommunications services supplied by a resident.[103]

(b) in combination with the *place of supply of a related supply*:

- services directly in connection with goods the supply of which was a zero-rated export.[104]

(c) in combination with the *location of land*, the *location of goods*, or the *place of effective use or enjoyment*, and with the *location of a third party receiver* proxy:[105]

- services (not including those directly in connection with land or goods in New Zealand when the services are performed and not being the acceptance of an obligation not to carry on a taxable activity in New Zealand).[106]

(d) in combination with the *location of a third party receiver* proxy:[107]

- a supply of information directly in connection with goods in New Zealand when the services are performed.[108]

(e) in combination with the *registration status of the person paying* for the services:

- services relating to goods under warranty that were taxed when they were imported.[109]

(4) The *place of (receipt of) performance* is used as a proxy for:

- services physically performed outside New Zealand. (For reverse charged services, this rule applies only if the services can only be physically received at the time and place or performance.)[110]

(5) The *place of supply of a related supply* is used as a proxy for:

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103 GST Act 1985 (NZ), s.11AB(a).

104 GST Act 1985 (NZ), s.11A(1)(k).

105 A third party receiver is a person, other than recipient, by whom the services are received in New Zealand otherwise than for the purpose of making taxable or exempt supplies: GST Act 1985 (NZ), s.11A(2).

106 GST Act 1985 (NZ), s.11A(1)(k). Using the place where a supplier has promised *not to do something* reveals a presumption that the recipient will consume the benefit of that promise in the place to which it relates. Since this could be somewhere other than the location or residence of the recipient and/or the supplier, this is effectively a *place of use or enjoyment* rule. Such a rule runs counter to the cost element principle, since the recipient may not have any presence, nor make any supplies, in that location and may acquire the promise for the purposes of a business it carries on elsewhere. For example, Company A in Country A may acquire a restrictive covenant to prevent a competitor, Company B, from operating in Country B even though A has no operations in B and no intention of setting up operations. If A exports goods or services to B, or to neighbouring Country C, the acquisition of the restrictive covenant relating to Country B may be a cost element of exports from Country A to Country B or C. If the services are taxed in Country B, A may have no effective way of recovering the input tax, in which case it will pass on the country B VAT in its prices. This will result in over-taxation when the VAT is factored into the price of an export to Country B, which is taxed again on import into that country, or the incorrect imposition of Country B VAT in the price of an import into Country C.

107 Having the same meaning as above, note 105.

108 GST Act 1985 (NZ), ss.11A(1)(l). The reference to the location of goods is not used here as a proxy for place of consumption. Instead, the character of the supply (being a supply of information about the goods) favours using the intangible proxies rather than a tangible proxy.

109 GST Act 1985 (NZ), s.11A(1)(ma).

110 GST Act 1985 (NZ), s.11A(1)(j) & s.11A(1B).

- arranging services physically performed outside New Zealand.[111]
- insuring, arranging the insurance of, or arranging zero-rated transport services.[112]

(6) The *location of the person initiating* the supply is used as a proxy for:

- telecommunications services initiated outside New Zealand.[113]

(7) The *place of effective use or enjoyment* is used for:

- specified intellectual property rights, know-how, confidential information, trade secrets, and similar rights for use outside New Zealand.[114]
- an acceptance of an obligation not to carry on a taxable activity somewhere outside New Zealand or not to pursue certain intellectual property rights that are for use outside New Zealand.[115]

In addition to the tangible/intangible categorisation of services by reference to the proxy used to determine place of taxation, these rules can be categorised by reference to whether they are *general* or *particular*, and whether they are *simple* or *complex*. A *general* rule applies a proxy to all supplies of services, without any sub-categorisation, whereas a *particular* rule is targeted at a specific type of service. The more particular the rule, the more it effectively adopts the European categorisation approach. A number of rules fall in between, because they apply to a particular sub-category of services, but the category is itself described generally. Thus:

- the rule for services to overseas postal organisations for delivery in New Zealand of postal articles mailed outside New Zealand is a *particular* rule;

- the rule for intangible services supplied to a non-resident who is outside New Zealand when the services are performed is a *general* rule, as is the exception to that rule if the services are received in New Zealand by a consumer; and

- the rules for services supplied directly in connection with goods or land are *general-to-particular* because they only apply to some services, but the services are not specified in any detail, merely described by reference to the level of connection with the goods or land.

Whether a rule should be described as *simple* or *complex* depends on how many iterations of different proxy applications are required to arrive at the final determination of place of taxation. A rule is *simple* if it involves the application of a *single proxy*, and even more so when that single proxy is applied to *particular* services. It is *complex* if it applies generally to all types of service but requires the application of a number of different proxies.

When the New Zealand rules are described in this way, by focussing on the proxies used, they appear to be more complex than under the European approach. To some extent this may be true, because rather than simply categorising services and then applying the relevant proxy,

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111 ibid. For reverse charged services these are subject to the same restriction as the underlying services.
112 GST Act 1985 (NZ), s.11A(1)(d).
113 GST Act 1985 (NZ), ss.11AB(b).
114 GST Act 1985 (NZ), ss.11A(1)(n) & 11A(4)(a).
115 GST Act 1985 (NZ), ss.11A(1)(o) & (p). See the earlier comment on this approach to restraints of trade, above note 106.

the more general and complex rules required the application of broad principles to determine place of taxation. In practice, however, the law is probably not more complex because practitioners quickly become familiar with deciding which proxy is the ultimate determiner of place of taxation for a particular supply.

3.2.c. Reverse charge mechanism

The rules described so far leave a gap in the application of New Zealand GST to services consumed in New Zealand. Only a limited range of supplies by non-residents are treated as made in New Zealand by the supplier (services physically performed in New Zealand in a B2C transaction, or in a B2B transaction with the agreement of the recipient). GST is imposed on these services by registration of the non-resident. Other services provided by non-residents for consumption in New Zealand are taxed using the reverse charge mechanism.

The reverse charge applies to services if:

- they are supplied by a non-resident to a resident;
- they would have been taxable if they had been supplied in New Zealand by a registered person in the course or furtherance of a taxable activity; and
- the recipient does not make supplies of which more than 95% in value are taxable supplies.[116]

Such supplies are treated as being made in New Zealand for the purpose of imposing the reverse charge, and as having been made by the recipient in the course or furtherance of a taxable activity carried on by the recipient. This means that they are counted in determining whether the recipient exceeds the registration threshold, so that in theory the reverse charge can operate in a B2C transaction, though it must be rare for a private consumer to import $40,000 of services in one year.[117]

Thus, the reverse charge differs from that in the European model in that it forms an essential part of the place of taxation rules, rather than merely being designed for administrative convenience. Nonetheless, in its practical effect it is largely similar since it operates for most B2B supplies from a non-resident to a resident.

3.3 Comparison

Under the European model, the short-circuiting of place of taxation rules by using place of supply to determine place of taxation means that supplies must be characterised before they can be subjected to the appropriate proxy. There is no general zero-rating of services but some exempt supplies are effectively zero-rated when they are supplied to non-residents, because they are exempt with credit, and a similar approach applies to some services (such as the Article 56/59 services) whose place of supply is outside the Community.[118] But in most cases, under the European model, the complex interactions between proxies occur in the place of supply rules, and zero-rating is a relatively less complex overlay.

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116 GST Act 1985 (NZ), ss.5B & 8(4B).

117 GST Act 1985 (NZ), ss.5B, 8(4B), & 51. See also Inland Revenue (NZ), *Tax Information Bulletin* (2004) Vol 16 No.1, pp.32-45.

118 EC VAT Directive, Article 169.

In contrast, the New Zealand GST model inverts this approach: the place of supply rules are relatively simple and the place of taxation is determined by the zero-rating rules. While there are some 'particular' zero-rating rules, most involve a general application of proxies without sub-categorisation of supplies.

Both models take a practical approach to non-resident suppliers, though in different ways. Under the European model, if a non-resident supplier is treated as making a supply in an EC Member State, the supply will be reverse charged if it is B2B and it is only for B2C supplies that registration and compliance with EC VAT might be required of a non-resident. Similarly, in New Zealand non-residents are only drawn into the GST regime if their supplies are performed in New Zealand for an end consumer, or for a registered person who has agreed that the supply can be treated as made in New Zealand. By excluding non-residents from the regime for B2B transactions and then using the reverse charge mechanism, the practical effect of the New Zealand GST is fundamentally similar to that of the EC, in that it is mainly for B2C supplies that registration and compliance with NZ GST might be required of a non-resident.

It is interesting to note that some EC Member States legislate to enact the EC VAT Directive in a way that creates convergence with the New Zealand origin-based place of supply model. Thus, for example, the Belgian VAT code overlays the place of supply rules in the EC VAT Directive with a presumption that goods or services are supplied in Belgium if either the supplier or the recipient are located in Belgium. Article 21§5 of the Code States:

> " Unless proved to the contrary, a supply of services is treated as taking place in Belgium if, at the time of supply, one of the parties to the transaction has its place of establishment, a fixed place, or its usual residence or place of abode in Belgium.[119]

Article 15§7 makes the same provision for goods.

3.4 The Australian Model

The Australian GST model is a hybrid between the European and New Zealand models. For goods, it is more closely aligned with the European model, while for services it is closely modelled on the New Zealand GST. For supplies of services, the key differences between the Australian model and the other models are:

(i) it has extensive application to non-resident businesses, who can be required to be registered on the basis of the *place of performance* proxy for both B2B and B2C supplies;

(ii) its use of the *location of the person to whom the services are provided* proxy is also extensive, preventing zero-rating of services supplied to non-residents whether the third party is a business or a consumer;

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119 In Dutch: "Behoudens tegenbewijs wordt de plaats van een dienst geacht zich in België te bevinden als één van de bij de dienst betrokken partijen er een zetel van economische activiteit of een vaste inrichting heeft gevestigd of, bij gebrek aan een dergelijke zetel of vaste inrichting, een woonplaats of een gebruikelijke verblijfplaats," *Wetboek van de Belasting over de toegevoegde waarde,* Art 21§5; in French: "Sauf preuve contraire, la prestation de services est réputée se situer en Belgique dès qu'une des parties à l'opération y a établi un siège d'activité économique ou un établissement stable ou, à défaut d'un tel siège ou d'un tel établissement stable, un domicile ou une résidence habituelle."*Code de la Taxe sur la valeur ajouteé,* Art 21§5.

(iii) it favours the use of general place of taxation rules, with few rules targeted at specific types of supply;

(iv) unlike Europe, which uses a refund scheme for non-resident businesses, and New Zealand, which does not provide refunds but endeavours not to tax services consumed elsewhere, Australia allows non-residents to recover input tax by registering for Australian GST, even when the non-resident makes no taxable supplies in Australia.

As a result of these features, the Australian GST is at the same time more strongly origin-based than the other models (because of the first and second features) and more destination-based (because of the third and fourth).

3.4.a. Place of taxation for services

The Australia place of taxation rules for services (things other than goods or real property) follows the New Zealand model:

- The place of supply (connection with Australia) is based on the location of the supplier and/or the place of performance.
- Exported services are GST-free; and
- Some B2B imported services are reverse charged.

A *connection with Australia*[120] is established if:

(1) the thing is done in Australia (*place of performance* proxy);[121]

(2) the supplier makes the supply through an enterprise it carries on in Australia (*location/residence of the supplier* proxy);[122] or

(3) neither of the above apply, but the supply is a right or option to acquire another thing, the supply of which would be connected with Australia (*place of performance* proxy).[123]

These rules are strongly origin-based and apply equally to resident and non-resident entities. Their breadth means that there is a need for broad zero-rating rules along similar lines to those used in the New Zealand model. However, while these rules appear to apply in the same way to all supplies, in practice the Commissioner has sub-divided supplies into 5 subcategories to which the *place of performance* proxy is applied differently: services, advice or information, instantaneous advice or information, rights, and obligations.[124] While not at the level of specificity with which the EC rules are designed, the desire to sub-categorise supplies clearly illustrates the need to move away from general proxies to more particular rules.

Services that are performed outside Australia, through an enterprise carried on outside Australia, and that do not involve a right or option to acquire something else in Australia will

120 An essential element of taxable supplies: GST Act 1999 (Aus), s.9-5(c).

121 GST Act 1999 (Aus), s.9-25(5)(a). This is not restricted to performance by the supplier. Nor is it restricted to physical performance, as the corresponding New Zealand rule is.

122 GST Act 1999 (Aus), s.9-25(5)(b) & 9-25(6).

123 GST Act 1999 (Aus), s.9-25(5)(c).

124 Commissioner of Taxation (Australia), GST Ruling *GSTR 2000/31 Goods and Services Tax: Supplies connected with Australia.*

not be taxed in a B2C transaction. Thus, for example, e-commerce supplies and telecommunications supplies from outside Australia to Australian consumers are not taxed.[125] Where supplied B2B, such services are taxed, if at all, using the reverse charge mechanism.[126]

For services that *are* connected with Australia, the *place of taxation* is determined by the GST-free rules for exported services.[127]

(1) The *location of land* is used as a proxy for services directly connected with :

- land outside Australia.[128]
- land in Australia (B2C and some B2B services).[129]

(2) The *location of goods* is used as a proxy for:

- services directly connected with goods outside Australia.[130]
- services physically performed on goods in Australia (B2C and some B2B services).[131]
- services of the repair, renovation, modification, or treatment of goods temporarily in Australia.[132]

(3) The *location* and/or *residence of the recipient*[133] are used as proxies for:

(a) on their own:

- services to a foreign postal administration for delivery or transit in Australia of postal articles mailed outside Australia.[134]
- a supply 'in relation to' rights.[135]

(b) in combination with the *place of supply of a related supply*:

- services the acquisition of which relates directly or directly, wholly or partly, to the making of an input taxed supply of real property in Australia.[136]

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125 Provision for the telecommunications supplies to be taxed is made in GST Act 1999 (Aus), Division 85, but the Commissioner has effectively abdicated the right to enforce these: TS 2000/1 *A New Tax System (Goods and Services Tax) Act 1999 Telecommunication Supplies Determination (No. 1) 2000*.

126 GST Act 1999 (Aus), Div 84.

127 GST Act 1999 (Aus), s.38-190, 38-355, 38-360, & 38-540. International transport supplies are not included in the analysis.

128 GST Act 1999 (Aus), s.38-190(1), item 1.

129 GST Act 1999 (Aus), s.38-190(1), items 2 & 3. Such services are not GST-free under these items.

130 GST Act 1999 (Aus), s.38-190(1), item 1.

131 above note 129.

132 GST Act 1999 (Aus), s.38-190(1), item 5.

133 GST Act 1999 (Aus), s.38-190(1), items 2 and 3 & s.38-190(3) & (4). For item 2, the recipient must be a non-resident who is not in Australia when the services are performed (the thing is done). For item 3, the recipient can be a resident or non-resident, but, subject to subsection (4), must be outside Australia when the services are performed.

134 GST Act 1999 (Aus), s.38-540. Although the rule refers to goods, that is merely to classify the supply. The place of taxation is determined by the intangible proxy of the status and location of the recipient.

135 GST Act 1999 (Aus), s.38-190(1), item 4. The Commissioner of Taxation interprets 'in relation to' to mean 'of' for the purposes of this item. Compare this with the New Zealand provision which details the rights to which it applies with a much greater level of specificity, above note 102.

136 GST Act 1999 (Aus), s.38-190(2A).

(c) in combination with the *location of land*, the *location of goods*, the *place of effective use or enjoyment*, and/or with the *location of a third party to whom the services are provided* proxy (the providee):[137]

- services not directly connected with land in Australia, nor physically performed on goods in Australia.[138]

(d) in combination with the *registration status* of the recipient:

- B2B services to a non-resident who is neither registered nor required to be registered.[139]

(4) The *place of supply for a related supply* is used as a proxy for:

- travel agents acting as such in arranging for supplies that will be effectively used or enjoyed outside Australia.[140]
- insuring, arranging the insurance of, or arranging GST-free transport services.[141]

(5) The intended *place of consumption* is used for:

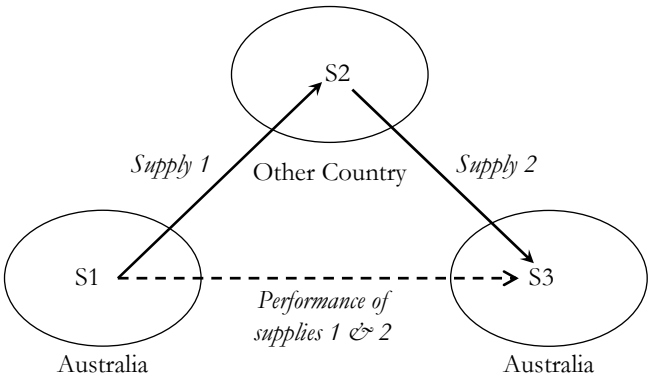
- supplies in relation to rights for use outside Australia.[142]

In theory, the place of consumption is also used for telecommunications supplies that are *effectively used or enjoyed* in Australia and for supplies (not being connected with real property, or physically performed on goods, in Australia) to a person who is outside Australia when the services are performed. However, in the former case, the Commissioner has chosen not to enforce this place of taxation rule, and in the latter he has interpreted it as a reference to the location of the person to whom the supply is actually provided.[143]

These rules clearly have much in common with the New Zealand rules. However, the use of the *location of a third party to whom services are provided* has impractical consequences for B2B transactions, particularly in the context of global services contracts, as illustrated in the following example.

137 GST Act 1999 (Aus), s.38-190(3) and s.38-190(4).
138 GST Act 1999 (Aus) , s.38-190(1) items 2 & 3.
139 GST Act 1999 (Aus), s.38-190(1) item 2(b).
140 GST Act 1999 (Aus), s.38-360.
141 GST Act 1999 (Aus), s.38-155 items 6 & 7.
142 GST Act 1999 (Aus), s.38-190(1) item 4(a).
143 See above note 38. Of course, the fact that this is the Commissioner's view does not necessarily mean it is correct but to date the interpretation of this rule has not been litigated.

Diagram 2: Australian round tripping rules



Australia applies a broad exception to its GST-free rules for exports of services in B2B 'grandma's flowers' situations. In the above diagram, S1, S2, and S3 are all entities carrying on business and registered for GST/VAT in their country of residence and location. S3 (in Australia) contracts with S2 (a non-resident) for the provision of services, and S2 sub-contracts the provision of part or all of the services to S1 (in Australia). S1 delivers the performance of the services directly to S3. Under the Australian GST, S1 cannot treat Supply 1 as a GST-free export because it provides the services directly to S3.[144] What is more, Supply 2 is connected with Australia (because the services are performed in Australia, albeit by S1) and S2 will be treated as making a taxable supply if it exceeds the registration threshold (currently $75,000).[145] Even if is not required to be registered, S2 is of course entitled to register in order to claim back the GST it has been charged,[146] but must then charge GST on the Supply 2, which is connected with Australia. If S2 does not register S3 cannot be required to reverse charge the GST on Supply 2,[147] but S2 will presumably pass on the GST charged by S1 in its price to S3, who will be unable to claim an input tax credit since it was not the recipient of Supply 1.[148]

In contrast, under the New Zealand GST, the equivalent round tripping rule does not apply to the supply by S1 to S2 because S3 is a registered person.[149] In most cases, the supply by S2 to S3 will also not be taxable to S2, because under the basic place of supply rule, a supply by a non-resident is not 'made in New Zealand.'[150] If S3 agrees, the parties can choose to have the supply treated as made in New Zealand,[151] but otherwise the supply will be reverse charged to S3.[152]

3.4.b. Reverse charge mechanism

The use of the reverse charge in the Australia GST also illustrates its hybrid features. There are two different kinds of reverse charge, both applicable only to B2B transactions.

144 GST Act 1999 (Aus), s.38-190(3).
145 GST Act 1999 (Aus), s.9-25(5)(a) & Division 188.
146 GST Act 1999 (Aus), s.23-10.
147 GST Act 1999, Div 84.
148 GST Act 1999, s.11-5.
149 GST Act 1985 (NZ), s.11A(2).
150 GST Act 1985 (NZ), s.8(2) & (3).
151 GST Act 1985 (NZ), s.8(4).
152 GST Act 1985 (NZ), ss.5B & 8(4B).

(1) The Division 83 reverse charge is similar to the European model. A recipient who is registered or required to be registered can apply this Division 83 reverse charge:

- for a supply of goods or services that is connected with Australia, other than a supply of a right or option to acquire something in Australia;
- if the supplier is a non-resident and does not make the supply through an enterprise it carries on in Australia, nor through a resident agent; and
- if the supplier and recipient have agreed to do so.

This voluntary reverse charge rule simplifies compliance (because it only applies at the option of the parties) but not administration (because the Commissioner cannot force the parties to use it). Thus, for example, if a non-resident who has no presence in Australia makes a taxable supply of services, the Commissioner must chase the supplier for the GST, not the recipient.

(2) The Division 84 reverse charge follows the New Zealand model. It applies:

- to supplies of services;
- that are not connected with Australia, or are the supply of a right or option to acquire a supply that would be connected with Australia;
- if the recipient of the supply:
  - acquires the thing supplied solely or partly for the purpose of an enterprise it carries on in Australia;
  - for consideration; and
  - is registered or required to be registered.

Thus, whereas the Division 83 reverse charge merely simplifies compliance in relation to an already taxable supply, the Division 84 reverse charge rule is an essential element of the place of taxation rules, because it ensures that GST applies on consumption of B2B supplies in Australia. Unlike the New Zealand, Australia does not apply the reverse charge to B2C transactions.

4. Causes and effects of cross-border GST conflicts

4.1 Effects of cross-border GST conflicts

In its work on cross-border services rules, the OECD has identified a number of problems that result from the application of conflicting jurisdictional rules, which arise out of the different approaches to legal design that have been illustrated above.[153]

- **Double or triple taxation:** For example, in the example of the cross-border Grandma's singing telegram, if the supplier's country determines place of taxation using the *location of the supplier* proxy, the grandson's country uses the *customer location* proxy, and the grandmother's country uses the *place of performance* proxy, triple taxation will occur.

153 Centre for Tax Policy and Administration, *The Application of Consumption Taxes to the Trade in International Services and Intangibles* (OECD, Paris, 30 June 2004), p. 12 at para 24.

- **Inappropriate taxation:** This arises when the place of taxation is not the place of consumption. This frequently occurs with B2C cross-border services transactions because of the practical difficulties of collecting the tax. Continuing with Grandma's singing telegram, if all countries apply the *location of the supplier* proxy, GST/VAT will be applied only once, but not in the country of consumption.

- **Non-taxation:** This will arise if the countries involved each use a proxy that determines the place of taxation to be outside their jurisdiction. Again applying this to Grandma's singing telegram, if the supplier's country uses the *customer location* proxy, the grandson's jurisdiction uses the *place of performance* proxy, and the grandmother's country uses the *location of the supplier* proxy, no country will collect GST/VAT on the supply.

- **General uncertainty:** This applies particularly to businesses operating in, or transacting with customers in, more than country. Competing principles and proxies can make it difficult for businesses to understand their obligations. The wide variations between place of taxation rules, with countries ranging across the full spectrum between the EC and New Zealand models, and differences in the understanding of how the proxies should apply, can make it very difficult for suppliers and their advisors to be fully conversant with the laws applying in each country.

- **High compliance costs:** Compliance costs are high both because of the need to comply with laws that differ from country to country and because of complexity within the laws of particular countries. Costs are also increased when non-resident businesses are required to register for GST/VAT in a foreign jurisdiction in which they have no place of business. As noted, the Australian GST is particularly problematic in this regard.

- **Non-compliance:** This can be a response to uncertainty and high compliance costs, particularly when suppliers are required to register in a country where they have no place of business. For revenue administrators, there are significant impracticalities involved in collecting GST/VAT on supplies of cross-border B2C services if the supplier does not voluntarily comply.

- **Supply chain inefficiencies:** These arise when GST/VAT is applied in cross-border B2B transactions, particularly when supplier and/or customer groups operate across many jurisdictions, and when supplies and acquisitions are subcontracted. Inappropriate application of tax can lead either to cascading and over-taxation, or to reorganisation of supply chains in order to avoid the adverse tax effects.

- **Barriers to market entry:** For the same reasons, over-taxation, under-taxation, and complex laws can create barriers to market entry and cause de facto disadvantages to either domestic or foreign businesses. Similarly, where adverse VAT/GST consequences favour vertical integration, this can create a barrier to the development of out-sourcing industries.

- **Distortions of competition:** Where cross-border conflicts adversely affect the neutrality of GST/VAT, some businesses will be advantaged, while others will be disadvantaged.

4.2 Causes of conflict

The causes of these conflicts, many of which should be evident from the preceding discussion of the role of proxies in place of taxation rules for services, were also noted by the OECD.[154]

4.2.a. Conflicting characterisation of supplies

Characterisation conflicts only lead to cross-border conflicts if they result in different proxies being applied to a particular transaction by different countries. The conflicts start at the most basic level, between what is goods and what is services. The European model treats leases of goods as supplies of *services*,[155] whereas Australia treats them as supplies of *goods*.[156] Where place of taxation rules require services to be sub-categorised, disputes arise about whether supplies do or do not fall into a particular category. Such disputes can arise even under the Australian law, which has few particular rules for services. The Commissioner of Taxation has nonetheless issued rulings that require sub-categorisation of supplies into particular types, albeit that they are described more generally than the European subcategories.[157]

Another characterisation difficulty arises when supplies have more than one element. One country may treat a supply as a single supply of X, while another treats it as a single supply of Y, and yet another treats it as two separate supplies of X and Y. If different proxies apply for determining the place of taxation for X and Y type supplies, these characterisation differences will lead to place of taxation conflicts.

4.2.b. Conflicting proxies

If different proxies point to the same place of taxation there is no conflict. For example, the EC VAT directive currently uses *place of performance* to determine the place of taxation of education,[158] while Australia uses the *location of the person to whom the services are provided*[159] but the resulting place of taxation is the same under both approaches. However, if proxies point to different places of taxation, double, triple, or non-taxation can arise. Thus, if some countries use *customer location* for education, then education provided to the employee of a non-resident employer under an agreement with the employer will be subject to a different rule than in countries using *place of performance* or *location of the person receiving the performance*. Singapore, for example, uses customer location for some B2B supplies of education.[160]

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154 ibid.

155 EC Vat Directive, Articles 14(1) & 24(1).

156 GST Act 1999 (Aus), ss.9-10(2) & 38-187 and definition of 'goods' in s.195-1.

157 see above, note 124.

158 EC VAT Directive, Article 52.

159 GST Act 1999 (Aus), s.38-190(1) items 2 and 3 and ss.38-190(3) & (4), as interpreted by the Commissioner of Taxation in Goods and Services Tax Rulings GSTR 2004/7 *Goods and Services Tax: In the application of items 2, 3 and paragraph (b) of item 4 in the table in subsection 38-190(1) of the A New Tax System (Goods and Services Tax) Act 1999: * when is a 'non-resident' or other 'recipient' of a supply 'not in Australia when the thing supplied is done'? * when is 'an entity that is not an Australian resident' 'outside Australia' when the thing supplied is done?* and GSTR 2007/2: above note 38.

160 *Goods and Services Tax Act Cap 117A* (Singapore), s.21(3)(k) and Goods and Services Tax (International Services) Order 1993 (G.N. No.S 513/93), Schedule 2, item 5(a) make 'training or retraining for any business or employment' zero-rated if they are supplied B2B to a non-resident. Being a zero-rating rule, this is more likely to result in under-taxation than over-taxation, depending on the law of the customer's jurisdiction.

4.2.c. Conflicting interpretation of proxies

Each of the proxies poses its own interpretative difficulties. *Tangible proxies* tend to be easier to interpret. If all countries are applying the *location of goods* rule at the same time for the same supply, it is difficult to imagine how they could reach different conclusions about the place of taxation. But the way in which the place of taxation rule determines whether the proxy applies may be more problematic, such as when the decision about whether to apply the *location of goods or land* proxy to services depends on whether there is a 'direct connection' with the land. Such disputes are really about conflicting proxies (because countries that do not find the requisite connection will apply a different proxy), rather than about different views of where land is located. The *place of performance* proxy is also open to different interpretations, particularly when used for electronic services and telecommunications.

Conflicting interpretations of *intangible proxies* are more common. If the *location* of a person is used as a proxy, countries can have different views about where the person is located, particularly when it comes to artificial entities, for which GST/VAT raises the same sorts of issues that the concept of a permanent establishment raises for income tax.[161]

Conflicting interpretation issues are necessarily more complex for services, because of the difficulty of being able to pin down how, where, and by whom services are consumed. Indeed, for the most part supplies of goods and of tangible services escape this particular conflict because intangible *location of a person* proxies are not used for such supplies.

In addition, some countries will interpret the intangible proxies strictly, using a *force of attraction* principle, so that the very presence of a branch in a particular country is said to attract services to that branch. Thus, for example if a supplier in Country A delivers services to customer in Country B, a country in which the supplier has a branch (or head office), Country B might treat the local branch (or head office) as having made the supply.[162]

Similarly to *force of attraction*, if the supplier in Country A delivers services to a customer in Country B, which has a local branch (or head office) in Country A, Country A might may treat the services as having been supplied to the local branch, or might deny zero-rating or GST-free treatment because of the presence of the local branch. An alternative, adopted in Australia and New Zealand, is to import a 'relevance' criterion into the law, so that the local presence of the customer (or a branch of the customer) must be in some way relevant to the receipt of the supply.[163]

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161 As an added complication, the appropriate relationship between the income tax concept and the concept of a GST/VAT establishment is not yet agreed and most countries generally do not have a complete correlation between the concepts used for the two taxes. In Australia, for determining whether a supply is 'connected with Australia,' a modified version of the income tax definition of a permanent establishment is used, but this takes no heed of any variations to that definition that apply for particular countries under the relevant DTAs: GST Act 1999 (Aus), s.9-25(6) & *Income Tax Assessment Act 1936*, s.6.

162 See OECD, below note 178, at para 7 of the Preface.

163 In New Zealand, the relevance criterion is enshrined in the law: see GST Act 1985 (NZ), s.11A(3), which ignores a minor presence in New Zealand, or a presence that is not effectively connected with the supply. In Australia, the relevance criterion is not stated in the law but is imputed to it by the Commissioner of Taxation. This interpretation first appeared in GSTR 2000/31, above note 124, and has been continued in most of the subsequent rulings on cross-border issues.

4.2.d. Different timing rules

Clearly using proxies that refer to the location of something moveable (whether it be goods or a person) creates a potential for conflicts if that thing/person moves between the time when one country applies the proxy and the time when another does. Time of supply rules in many GST/VAT laws are merely tax accounting rules, which require tax to be paid at a time different from that at which the supply is actually performed. Moreover, not all countries define time of supply in the same way.[164] Thus, if the *place of taxation* rule is required to be applied at the time of supply, different countries will be applying it at different times.

As an alternative to applying proxies at the time of supply, *place of taxation* rules can require them to be applied at the *time of performance*. Thus, in the Australian law, the GST-free rules for exported services are mostly applied 'when the thing supplied is done.'[165] Similarly, the New Zealand zero-rating rules for exported services are mostly applied at the time of performance.[166]

Clearly the time of *performance* of the supply is the most appropriate time to apply the proxies because it is by performance that the customer is put in a position where it can consume the thing supplied. The fact that the time of supply for tax accounting purposes might be earlier should not affect this conclusion. For this reasons, only a few years ago New Zealand amended its zero-rating rules for goods supplied outside New Zealand, which were previously zero-rated if the goods were outside New Zealand *at the time of supply* and were not to be imported by the supplier. The new rule zero-rates the goods if they are outside New Zealand at both the time of supply and *the time of the delivery* and/or (if imported) the recipient pays GST when they are imported.[167] The need for this change arose because of evasion schemes that took advantage of the fact that the proxy was applied at the *time of supply*, which under New Zealand law can take place before the supply occurs.[168]

Time of supply rules that require GST/VAT to be accounted for in advance of performance necessarily require predictions about the character of the supply, for example that the supplier will still be a registered person when the supply is made, that the tax rate will be unchanged, and that the supply will not be cancelled. When such predictions turn out to be incorrect, credit/debit/adjustment notes are issued to correct the GST accounting to reflect the transaction actually performed.[169] When it comes to place of taxation, a supplier who must account for tax on a supply before it is performed must predict whether it will be an export or a local supply, just as the customer must predict whether it will be making a local purchase or a reverse charged taxable import of services. Where the prediction is incorrect, the adjustment provisions will operate. That this is the case is clearly envisaged in the Australian

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164 For a discussion of the relationship between time of supply for accounting purposes and for taxable event purposes, see Millar, R, 'Time is of the Essence: Supplies, Grouping Schemes and Cancelled Transactions' *Journal of Australian Taxation*, Vol. 7, No. 2, p. 132, 2004, available at SSRN: http://ssrn.com/abstract=711581.

165 GST Act 1999 (Aus), s.38-190.

166 GST Act 1985 (NZ), s.11A.

167 GST Act 1985 (NZ), s.11(1)(j) was substituted, from 3 April 2006, with application for supplies made as from 19 May 2005, by *Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006* (Act No.3 of 2006), s.288(1).

168 See the New Zealand Inland Revenue's summary of the new provisions on http://www.ird.govt.nz/technical-tax/legislation/2006/2006-3/leg-2006-3-gst-goods-out-nz-at-supply.html.

169 See above, note 164.

law, which makes specific reference to adjustments being required when a supply of goods is accounted for as an export but the goods are not in fact exported.[170]

4.2.e. Conflicting approaches to the place of effective use or enjoyment and conflicting concepts of consumption

The differences in approach to the place of effective use or enjoyment rule were noted in Section 2.4.b above. A few countries treat *place of effective use or enjoyment* as a pure place of consumption test, applying it differently from transaction to transaction. Some treat it as a reference to a single other proxy, while others read it is a statement of an over-riding intention to apply the destination principle and therefore as an invitation to expand it into a range of rules applying different proxies to different types of supply.

The different choices about how to apply a place of effective use or enjoyment rule mirror the choices about what proxies to put in a VAT/GST law in the first place and are underpinned by the particular concepts of consumption held in each country. Thus, for example, views on the place of consumption of advertising services differ from one country to the next. Australia and New Zealand see advertising as a service that, when contracted for, organised, delivered to, and paid for by one person, should not be seen as having been provided to/received by another person merely because that person benefits from the advertising.[171] As a result, they apply the *customer location* proxy and do not apply their over-ride rules, which focus on the *location of another person* receiving the performance of the advertising services. They view advertising as being necessarily consumed by the person contracting to have it supplied. A similar view underlies the choice to include advertising in the list of services that are effectively zero-rated when supplied from an EC Member State to a customer outside the EC.[172] In contrast, Singapore appears to view advertising as something that is consumed by the viewers reading or watching the advertisement, or by other persons in Singapore who might potentially sell the advertised products to the viewers. Thus, it uses a *place of performance* proxy for advertising by not zero-rating advertising supplied to a non-resident unless the advertisement is 'promulgated outside Singapore'.[173] This is an unusual concept of consumption and clearly runs counter to the cost element principle.

Education is another example of a service for which countries have conflicting concepts of consumption. For an end consumer resident in Country A but undertaking an education course in Country B, it might well be said that the process of being educated can only be consumed in Country B at the time the services are provided, though even that is open to discussion since the benefit of the education will presumably be used by consumer back in Country A after the course is over. For a Country A business sending its employees to Country B to undertake training courses, the question is more complex. In one sense, it might be said that only the employees can actually consume the education, since the business itself cannot be educated. But it is the employer that is paying for the education in the course of its business, and it can equally well be argued that the education forms a cost element of the supplies subsequently to be made by the employer in Country A. As noted earlier, the

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170 GST Act 1999 (Aus), example to s.19-10(1).

171 Inland Revenue (NZ), Public Ruling Br Pub 03/03 *Advertising Space and Advertising Time Supplied To Non-Residents – GST Treatment* (2003). In Australia, there are some limitations on this treatment if the advertising services relate to a supply of input taxed real property in Australia: GST Act 1999 (Aus), s.38-190(2A). See also the GST rulings cited above at note 159.

172 See Sections 3.1.a and 3.1.b of this paper.

173 *Goods and Services Tax Act Cap 117A* (Singapore), s.21(3)(u).

Singapore law implicitly recognises this second view of consumption by zero-rating such supplies, whereas the EC VAT Directive and the Australian GST law favour the first view.[174]

4.2.f. Different concepts of taxable person and taxable transaction

Throughout this paper I have made a distinction between B2B and B2C transactions, as if that distinction will always be clear. However, if B2B transactions are to have different place of taxation rules to take account of the cost element principle, then issues will arise about how to distinguish between businesses and consumers. One option is to rely on the GST/VAT registration of other countries, but this is not always a useful guide, because countries do not have identical registration regimes, and certainly do not have identical concepts of who is a taxable person. Nonetheless, if the reverse charge mechanism is to be widely recommended for B2B transactions, it will be important to at least know whether the customer is registered for VAT/GST in its country and it may be that registration turns out to be the only effective means for countries to distinguish between B2B and B2C supplies.

5. Recent OECD Developments

The history of the OECD's interest in cross-border consumption tax issues is short when compared with income tax. In the 1990s, the increasing recognition of cross-border consumption tax conflicts led to a number of recommendations being made in the 1998 Ottawa Framework Conditions for e-Commerce, the most important of which were:[175]

- that GST/VAT should be imposed in the jurisdiction where consumption takes place;
- that an international consensus should be sought on how to determine where particular supplies should be regarded as consumed; and
- that countries should consider using the reverse charge mechanism recommended for imported services and intangibles.

Thereafter, the OECD released specific guidelines for applying GST/VAT to e-Commerce, three short papers in the Consumption Tax Guidance Series,[176] and some reports with draft principles,[177] before commencing its current work in 2006 with the release of the beginnings of the *International VAT/GST Guidelines*.[178] The Guidelines include an extensive table of contents, indicating the intended breadth of their coverage, but only a small part of the content has been fleshed out and significant parts of the Guidelines are yet to be populated.

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174 See Section 4.2.b of this paper and also the discussion of education in R Millar, "GST Issues for International Services Transactions" (2004) *Australian GST Journal*, Vol.4, p.285, Available at SSRN: http://ssrn.com/abstract=671541, example 1, pp.302-305.

175 "Electronic Commerce: Taxation Framework Conditions" *A Report by the Committee on Fiscal Affairs,* as presented to Ministers at the OECD Ministerial Conference, "A Borderless World: Realising the Potential of Electronic Commerce" (8 October 1998) *(http://www.oecd.org/dataoecd/46/3/1923256.pdf).*

176 Centre for Tax Policy and Administration, *Guidelines on Consumption Taxation of Cross-Border Services and Intangible Property in the Context of E-commerce* (OECD, Paris, 2001); Consumption Tax Guidance Series Consumption Tax Guidance Series: Paper No 1: *Electronic Commerce – Commentary on Place of Consumption for Business-to-Business Supplies (Business Presence);* Paper No 2: *Electronic Commerce: Simplified Registration Guidance Paper*, No 3: *Electronic Commerce: Verification of Customer Status and Jurisdiction.*

177 OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, Fiscal Affairs Committee, 2004; OECD, The *Application of Consumption Taxes to the Trade in International Services and Intangibles: Progress Report and Draft Principles*, Fiscal Affairs Committee, 2005

178 Centre for Tax Policy and Administration, *International VAT/GST Guidelines*, (OECD, Paris, February 2006).

The Guidelines note that the Committee on Fiscal Affairs (CFA) has agreed on the following basic principles:[179]

> " For consumption tax purposes internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption.
>
> The burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation."

The first of these principles is the *destination principle*; the second recognises the importance of what I have referred to in this paper as the *cost element principle*.

In addition, it was agreed that it is impractical and inappropriate to draft legal rules that simply allocate taxing powers on the basis of the jurisdiction of consumption and that instead proxies should be used to identify the place of consumption. For this purpose, in keeping with the Guidelines developed for e-Commerce, *customer location* should be the primary proxy (the *Main Rule*).

A Technical Advisory Group (TAG) was set up, to assist the CFA's Working Party No.9 in developing guidelines on how to implement these principles in practice, how to apply the Main Rule, and what other proxies should play a role.[180] The TAG was also charged with assisting the Working Party's work on cross-border refund mechanisms. As the work progresses, consultation documents have been issued inviting comments from the general public in order to inform the process of developing the guidelines.

The documents issued to date are:

Title	**Issued**	**Respond by**
International VAT/GST Guidelines	23/02/06	-
First Consultation Document[181]	10/01/08	30/04/08
Public comments on the First Consultation Document[182]	30/06/08	-
Second Consultation Document[183]	01/07/08	17/10/08
VAT Refund Questionnaire[184]	01/07/08	10/08/08

179 ibid at paragraph 9. Footnote 1 of the document notes that Luxemburg expressed its reservation on the second of these principles and that Germany expressed its reservations to all of the Basic Principles outlined in the *Guidelines*. By January 2008, it appeared that Germany might have withdrawn its reservations: see the First Consultation Document, above note 34, page 4, footnote 1, which makes no mention of the German reservation.

180 The TAG participants include the OECD secretariat, representatives from Government and the business community, and academics. Professor Walter Hellerstein, Shackleford Professor of Taxation at the University of Georgia School of Law, has been an academic advisor to Working Party No.9 since the late 1990s. The author's role as the second academic advisor commenced in 2007 with the establishment of the current TAG.

181 First Consultation Document, above, note 34.

182 Committee on Fiscal Affairs, Working Party No9 on Consumption Taxes, Centre for Tax Policy and Administration, *Applying VAT/GST to Cross-Border Trade in Services and Intangibles: Emerging Concepts for Defining Place of Taxation – Outcome of the First Consultation Document* (OECD, Paris, June 2008)

183 Committee on Fiscal Affairs, Working Party No9 on Consumption Taxes, Centre for Tax Policy and Administration, *Applying VAT/GST to Cross-Border Trade in Services and Intangibles: Emerging Concepts for Defining Place of Taxation - Second Consultation Document – Invitation for Comments*, (OECD, Paris, June 2008) (the Second Consultation Document).

The First and Second Consultation Documents set out the preliminary ideas developed by Working Party No.9 with the assistance of the TAG. It is important to bear in mind that these are working documents, released for the purposes of consultation, and are not guidelines that countries should at this stage be following. Depending on the outcome of consultations, and the subsequent progress of the TAG's work, the preliminary ideas expressed in the documents might well be modified. As both documents note:[185]

> " The attention of participants is drawn to the fact that this document reflects work in progress and that solutions or conclusions that are presented should not be considered, at this stage, as part of the guidelines. Draft guidelines will be presented for consultation at a later stage as a result of the work of the Committee.
>
> This document does not necessarily reflect the views of either the OECD nor of its member countries."

In addition, it is as important to read the documents in light of what they don't say as much as what they do say:

- they only cover B2B transactions, not B2C transactions;[186]
- they only cover B2B supplies to recipients that are registered for GST/VAT in their own jurisdictions, not B2B transactions to entities that, while not being consumers, are not required to register for GST/VAT;[187]
- they only cover legitimate transactions, not those involving evasion or avoidance;[188]
- they only deal with transactions between separate legal entities and do not address establishment issues;[189]
- they adopt a one-step-at-a-time approach to developing the ideas,[190] which means that the conclusion reached for each worked example should be taken to apply only in the exact circumstances the example addresses, and should not be used to extrapolate beyond the conclusions actually reached in the paper;
- they do not address the question of when and how exceptions to the Main Rule should be applied, though they do note that the idea will be to have as few exceptions as possible;[191]
- they recognise that exceptions could result in VAT being charged to businesses in countries where they are not established, which might need to be dealt with by allowing refunds for foreign businesses.[192]

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184 Centre for Tax Policy and Administration, *Business Survey Foreign VAT/GST Refunds: Magnitude and Associated Costs* (OECD, Paris, June 2008).
185 First Consultation Document, above note 34, p.3; Second Consultation Document, above note 183, p.3.
186 First Consultation Document, above note 34, p.5 para 6.
187 First Consultation Document, above note 34, p.5 footnote 2.
188 First Consultation Document, above note 34, p.5 para 6.
189 ibid
190 First Consultation Document, above note 34, p.4 para 6.
191 First Consultation Document, above note 34, p.4 para 5.

As the consultation process proceeds, the issues will become more complex as the papers start to address B2B transactions with persons not identified for GST/VAT, B2C transactions, the use of exceptions based on tangible proxies or other intangible proxies, the use of over-ride rules (whether specific or general), establishment issues, avoidance, and evasion.

Keeping in mind these limitations, the following sections explain the principles outlined in each of the consultation documents and consider how the Australian GST performs in the various examples discussed in the documents, applying the rules outlined earlier in Section 0.

5.1 The First Consultation Document

The First Consultation Document focuses on extremely simple examples. It does not, for example, even attempt to define what the terms "supplier," "customer," or "supply" mean. It does include a definition of "business agreement" but this is not said to be a final or definitive definition, merely one to be used for the purposes of the simple examples considered in the paper. This definition is needed because although the document does not define "customer," it identifies the customer as the person to whom the supply is made, and identifies that person from the business agreement.[193] For these purposes:

> …the term "business agreement" is taken to mean any agreement, regardless of form, between persons acting in a business capacity that underlies the provision of a supply.[194]

Three general conclusions to be drawn from the First Consultation Document are as follows:

1. The Main Rule for determining the place of taxation of a B2B supply should use the *customer location* proxy.[195]

2. Place of taxation will be determined on a transactional basis, which means that:[196]
   - the customer and customer location will be identified from the business agreement;
   - the place of taxation will be determined independently for each transaction;
   - relationships between the parties should not alter the place of taxation, so long as each supply is independent;
   - the fact that one supply is used as an input to another does not alter the place of taxation for either supply.

3. The reverse charge mechanism is recommended for B2B supplies where the customer is in a different jurisdiction from the supplier "as far as this type of mechanism is consistent with the overall design of the national consumption tax system," though it

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192 ibid. Sometimes a refund might not be appropriate: OECD, *International VAT/GST Guidelines*, above note 178, paras 10-12. See also the comment about intentionally unrecoverable tax being a normal part of a VAT/GST for tax policy reasons, giving the example of cars and business entertainment: First Consultation Document, above note 34, p.5 para 8

193 First Consultation Document, above note 34, p.5 para 9.

194 First Consultation Document, above note 34, p.5 footnote 3

195 First Consultation Document, above note 34, p.4 para 4; p.5 para 9

196 First Consultation Document, above note 34, p.5 para 9 and p.12 para 25. The conclusions are not summarised in exactly the same terms in the document, but I do not believe that they have been restated inconsistently with the intent of the document or the examples therein.

will then be up to the customer's jurisdiction to decide whether to actually collect tax from the customer. However, a caution is sounded that 'issues' with the reverse charge mechanism may need addressing at a later stage.[197]

Australia's GST law appears to be largely consistent with these recommendations. First, in terms of the two fundamental principles (destination principle and the cost element principle) set by the CFA as parameters for the Guidelines, it is clear that Australia's GST is intended to comply. It is designed in accordance with the destination principle and in its approach to non-resident registration and input tax credits it is broadly capable of ensuring that the burden of GST is not borne by foreign businesses in such a way as to become cost elements of supplies they make outside Australia.

At the level of the three more specific conclusions in the First Consultation Document:

(1) Australia does have a general rule that determines the place of taxation for B2B supplies by using the *customer location* proxy. That rule is embodied in items 2 and 3 of section 38-190(1). It is true that these items are subject to some exceptions, for which *tangible* proxies or the *location of a third person to whom the supply is provided* are used, but the First Consultation Paper recognises that there will be situations where it is appropriate to have exceptions.

(2) The Australian GST is clearly designed on a transactional basis and the Commissioner of Taxation has issued a number of rulings in which he confirms that for GST purposes the recipient of a supply (the customer) is the person to whom the supply is made under an agreement with the supplier (the contractual flow), irrespective of whether the customer or a third party is the person to whom the goods or services supplied are actually provided (the actual flow).[198]

(3) The Australian GST does incorporate two types of reverse charge mechanism. However, on this point the law may not be completely in line with the principles stated in the First Consultation Paper. Where a non-resident makes a supply to a customer in Australia, if the supply is performed in Australia (the thing is done in Australia) but is not made through an enterprise carried on in Australia, reverse charging is not the norm but the exception and the application of the reverse charge is subject to the agreement of the recipient.[199] While acknowledging disclaimers in the Consultation Paper, it seems highly likely that a wider use of B2B reverse charging will eventually be recommended and this is one area where Australia could benefit from reconsidering its position in advance of the issue of the final Guidelines.

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197 First Consultation Document, above note 34, p6 para 12.

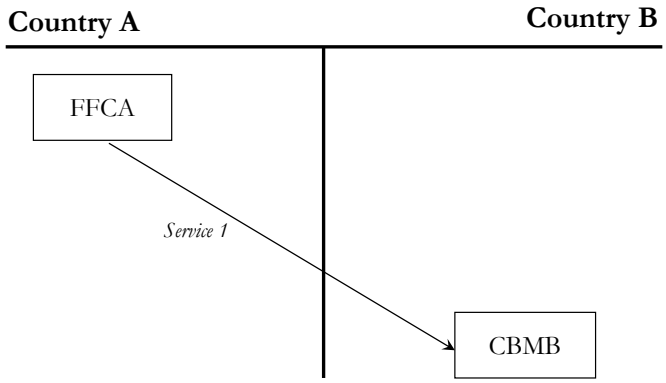
198 Commissioner of Taxation (Australia), Goods and Services Tax Ruling GSTR 2006/9 *Goods and Services Tax: supplies*

199 New Zealand's law is more compliant in this regard, because its *out-in-out-in* approach to non-residents means most B2B supplies from non-residents to residents are taxed (if at all) using the reverse charge mechanism and this is only *not* the case when the supplier wants to be registered (presumably because it is incurring otherwise unrecoverable input tax) and the recipient has agreed. Where Australia makes registration the norm and the reverse charge optional, New Zealand makes the reverse charge the norm and registration optional.

5.1.a. The first 5 steps

The conclusions reached in the First Consultation Paper are illustrated using a series of examples, each one adding a further level of complexity. All of the examples presume the operation of a B2B reverse charge when the supplier is not established in the country where GST/VAT applies.[200]

STEP 1: A single transaction[201]



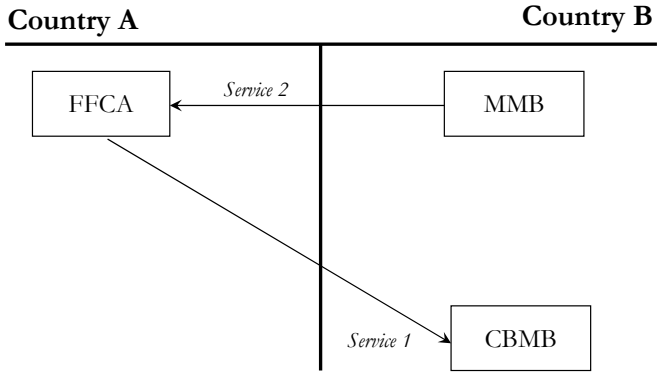
In the first example, CBMB in Country B is considering expanding its business into Country A. It enters into a business agreement with FFCA, an unrelated company carrying on business in Country A, under which FFCA supplies to CBMB the services of analysing market conditions in Country A. FFCA is the supplier, CBMB is the customer, and the Main Rule dictates that Country B is the place of taxation The result would be the same if FFCA and CBMB were related entities. FFCA should not be required to register and CBMB should account for GST on a reverse charge basis.

Australia: Australia's law is consistent with these recommendations.

- If Country A were Australia, Service 1 would be GST-free.[202]
- If Country B were Australia, FFCA would not be required to register because the supply would not be connected with Australia.[203] If GST were applied at all, it would be under the compulsory reverse charge mechanism.[204]

200 First Consultation Document, above note 34, p.6 para 12.
201 First Consultation Document, above note 34, Step 1, p.7, entitled 'Transaction between 2 separate legal entities (whether related by common ownership or not)' in the document.
202 GST Act 1999 (Aus), s.38-190(1), item 2.
203 GST Act 1999 (Aus), s.9-25(5).
204 GST Act 1999 (Aus), Div 84 .

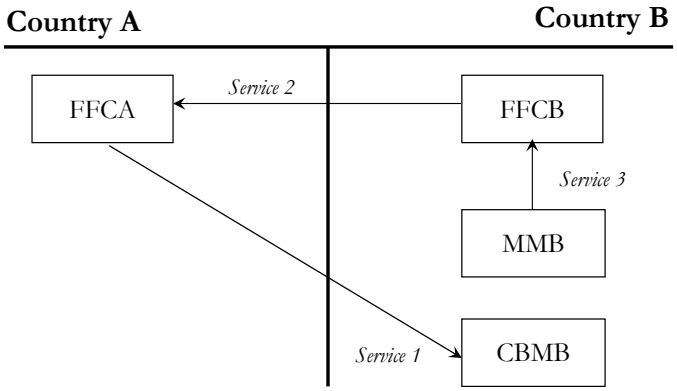
STEP 2: Two separate and unrelated transactions[205]



In this example, MMB (a marketing company in Country B) is added to the picture. FFCA is considering expanding its operations into Country B, and enters into a business agreement with MMB for the provision of marketing services. MMB is unrelated to either of the other two parties. The supply between FFCA and CBMB continues as before. The supply by MMB as supplier to FFCA as customer is totally unrelated to the supply between FFCA and CBMB. In accordance with the Main Rule, Country A is the place of taxation for this new supply, because FFCA is located in Country A.

Australia: With the addition of Service 2, Australia's law remains consistent with the recommendations. The application for Service 2 is essentially the reverse of that described for Service 1 in Step 1.

STEP 3: Related and unrelated supplies[206]



In the third example, FFCA sets up a subsidiary in Country B and that subsidiary now provides the services previously provided by MMB. The supply by FFCB to FFCA is identified from the business agreement between them and its place of taxation is Country A, just as was the case when MMB supplied the services. Occasionally, FFCB engages MMB (Service 3) to provide services it needs for its supply to FFCA (Service 2). Thus, Service 3 and Service 2 are related, because FFCB uses Service 3 (its input) to make Service 2 (its output).

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205 First Consultation Document, above note 34, Step 2, p.8, entitled 'Two separate Transactions involving three separate legal entities' in the document.

206 First Consultation Document, above note 34, Step 3, p.9, entitled 'Transactions involving a third party' in the document.

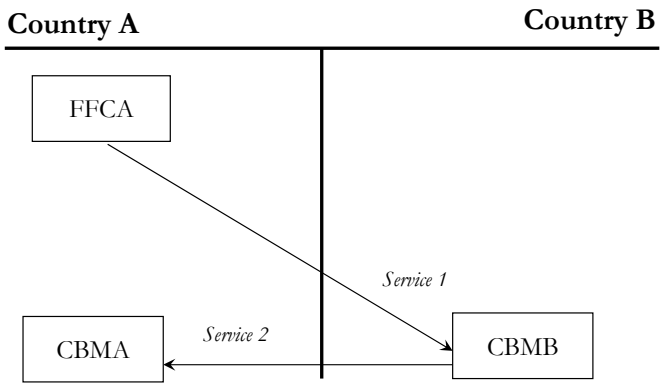
Nonetheless, each supply is taxed independently according to the Main Rule, so the place of taxation for Service 3 is Country B, while the place of taxation for Service 2 is Country A. The supply of Service 1 by FFCA to CBMB continues on as before and its place of taxation remains unchanged. Services 1 and 2 are reverse charged, because the supplier is not established at the place of taxation. Service 3 is a local domestic supply, for which GST/VAT is payable by MMB.

Australia: Australia's law continues to apply correctly for Services 1 and 2 and now also for Service 3.

- If Country A were Australia, Service 3 would not be taxable because it would not be connected with Australia. Nor would the reverse charge apply, because MMB provides its services to FFCB (who does not carry on an enterprise in Australia) not to FFCA.

- If Country B were Australia, Service 3 would be a taxable supply because it would be connected with Australia and would not be GST-free.

STEP 4: Related supplies: customer group[207]



In the fourth example, FFCB and MMB fall out of the picture. Now, CBMB sets up a wholly owned subsidiary in Country A (CBMA). CBMB provides centralised analytical and data gathering services. CBMA enters into a business agreement with its parent, CBMB for the supply of information it needs to conduct its business. CBMB gets some of that information by engaging FFCA to provide it with a report, which it is permitted to disclose or sell. The Consultation Document specifically notes that no intentional or unintentional relationship is created between FFCA or CBMA (presumably because contact between them may potentially alter the place of taxation analysis).[208] Again, the place of taxation for each supply is determined separately by applying the main rule. Thus, the place of taxation for Service 1 is Country B and for Service 2 is Country A. The place of taxation is not affected by the fact that CBMA and CBMB are related; nor is it relevant that CBMA is in the same country as FFCA, or that Service 2 incorporates the results of Service 1.

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207 First Consultation Document, above note 34, Step 4, p.10, entitled 'Transactions involving a customer group' in the document.

208 First Consultation Document, above note 34, p.10 footnote 4.

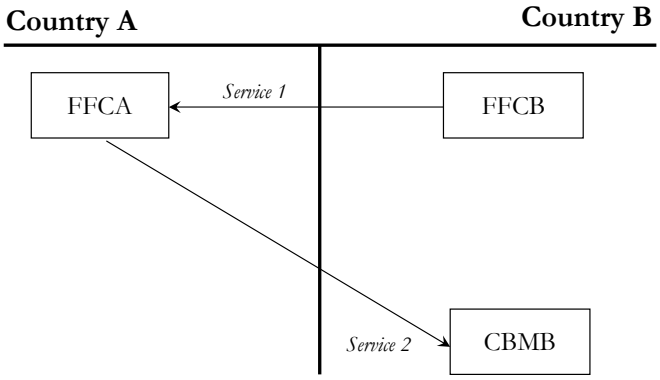
Australia: The Australian law continues to correctly identify the place of taxation. The relationship between CBMA and CBMB does not affect the place of taxation.

- If Country A were Australia, Service 1 would be GST-free. The Consultation Document specifies that FFCA does not provide the services directly to CBMA, which means that the presence of CBMA in Australia would not alter the GST-free status of the supply.[209] The place of taxation for Service 2 would also be Australia, but the fact that Service 2 incorporates the results of Service 1 could be problematic, as it is not certain that the compulsory reverse charge would apply. Whether it would depends on the characterisation of the services. If CBMB supplies *information gathering and analysis* services that are performed in Country B, and has merely incorporated information acquired from FFCA into its report, the compulsory reverse charge would apply. However, if CBMA engaged CBMB to supply services, the performance of part of those services was 'done' in Country A by FFCA. Even though CBMB did not perform the services itself, Service 2 would partly *connected with Australia.*[210] This would mean that CBMB could be required to register for GST. However, in this circumstance, the voluntary reverse charge could probably be used.[211]

  This difficulty would not arise in New Zealand because the place of performance proxy is not used for B2B supplies by non-residents.

- If Country B were Australia, the theoretical place of taxation for Service 1 would be Country B, but the reverse charge would probably be suspended because the services are acquired as inputs to a GST-free on-supply, which means that CBMB would be entitled to full input tax credits if GST were applicable.[212] Service 2 would be GST-free because it is supplied to a non-resident and none of the exceptions would apply.

STEP 5: Related supplies: supplier group[213]



Step 5 is logically indistinguishable from Step 4, except that now there is a supplier group rather than a customer group. FFCB now undertakes a wider range of activities for FFCA

209 GST Act 1999 (Aus), s.38-190(3) would not apply.

210 This conclusion is based on the sub-categorisation of supplies of 'things other than goods or real property' proposed by the Commissioner of Taxation in GSTR 2000/31, above note 124.

211 GST Act 1999 (Aus), Div 83.

212 GST Act 1999 (Aus), Div 84.

213 First Consultation Document, above note 34, Step 5, p.11, entitled 'Transactions involving a supplier group' in the document.

(not only marketing). CBMB is also engaging FFCA for a wider range of services because it is getting market analysis information about Country B as well as Country A. Service 1 from FFCB to FFCA is incorporated into Service 2 from FFCA to CBMB. Again, each supply is taxed in accordance with the Main Rule and without reference to the other.

Australia: In terms of the Australian law, the analysis for Step 4 is simply reversed, so that it is when Country B is Australia that there is a potential problem with the collection mechanism depending on how Service 2 is characterised. If part of FFCA's supply is treated as connected with Australia because it is performed in Australia by FFCB, FFCA might be required to register and pay GST on Service 2, which should be reverse charged to CBMB. However, the option of the voluntary reverse charge would be available, subject to CBMB's agreement.

5.1.b. Comments on the First Consultation Document

The OECD received surprisingly little direct feedback from businesses and organisations on the First Consultation Document.[214] Only seven responses were received, and none specifically rejected any of the conclusions reached. Most comments broadly supported the approach, and some pointed to issues that will need to be dealt with in future papers, namely establishment issues, characterisation of supplies, confirming that the reverse charge mechanism is recommended only for cross-border transactions, not for domestic B2B transactions, dispute resolution mechanisms etc. This may be because the examples were relatively simple but it would be encouraging to see a wider response to the Second Consultation Paper.

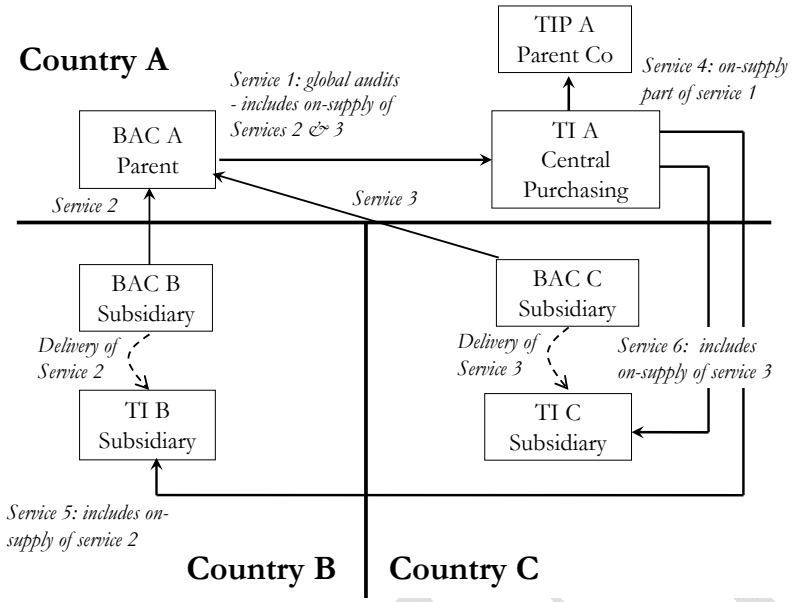
From Australia's point of view, no obvious difficulty with its place of taxation rules is highlighted by the 5 steps, though the optional use of the reverse charge mechanism seems likely to be cause for concern.

5.2 The Second Consultation Document

The Second Consultation Document commences with all the same preliminaries about what it does not say and what situations are not covered and these are not repeated here. This document takes the principles established in the 5 steps of the first document and applies them to four examples of complex global agreements. Only one of the examples actually involves cross-border supplies. The purpose of the other three examples is to show that even in complex global arrangements, the Main Rule can have the effect that every supply is treated as a domestic supply, in which supplier and recipient are co-located in the place of taxation.

214 above, note 182.

Example 1: A Global Agreement[215]



This example shows that the principles and understandings from the First Consultation Document can be applied in the context of global agreements. In the example, there are two related groups with operations in Countries A, B, and C. The TI group has its Parent company and a central purchasing company in Country A, and subsidiaries in Countries B and C. The central purchasing company (TI A CP) enters into a global auditing arrangement with BAC A in Country A. The services to be conducted are audits to meet the domestic legal requirements of each company being audited . Since BAC A has no presence in Countries B and C, it subcontracts its subsidiaries in those countries to perform the services. The facts specifically state that no stewardship issues arise, i.e. that the audits of TIP's subsidiaries do not include work done purely for the benefit of TIP as a shareholder. Such issues are covered in the separate audit done for TIP. The facts also state that BAC B and BAC C "physically perform the services directly to" TI B and TI C.

Although the Consultation Document does not make this point, there is no reason to suppose that the place of taxation would be determined differently if all of the parties were unrelated, rather than being members of two groups of companies.[216]

The Consultation Document concludes that the Main Rule is appropriate for determining the place of taxation for each supply in this global contracting arrangement. Services 2 and 3 are cross-border transactions taxable in Country A because they are supplied to BAC A, the customer in Country A. Service 1, which includes the on-supply of Services 2 and 3, and the audits of TI A CP and TIP A, is a domestic transaction in Country A, as is Service 4, which on-supplies that part of Service 1 that is the audit of TI P. Services 5 and 6 are cross-border transactions, involving the on-supply of Services 2 and 3 respectively. The place of taxation

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215 Second Consultation Document, above note 183, p5. I have taken liberties with the diagram by including information about which supply includes on-supplies of other supplies, and by drawing in the physical delivery of the services in Countries B and C. These changes merely include in the diagram what is stated in words in the document and are therefore consistent with the OECD version.

216 Second Consultation Document, above note 183, p.6 fn 1. The also OECD acknowledges that in reality auditing arrangements will not be conducted by related companies.

for Service 5 is Country B and for Service 6 is Country C, in each case because this is where the customer is located.

Australia = Country A: If Australia were Country A, its law would essentially be compliant. Services 1 and 4 would be local taxable supplies (connected with Australia and not GST-free), and Services 5 and 6 would be GST-free exports. Services 2 and 3 would not be connected with Australia, but the compulsory reverse charge would be suspended because they are acquired for the purposes of on-supply in a taxable supply (i.e. BAC A would be entitled to full input tax credits if GST were charged). Furthermore, part of Service 1 would be GST-free. That is because as well as a round-tripping rule that limits GST-export treatment, Australian GST has a round-tripping rule that expands such treatment where a supply of services is made to a recipient who is located in Australia (in this case TI A CP) but provided to another entity outside Australia (TI B and TI C). In such cases, TI A CP would be treated as being outside Australia, and since the auditing services relate to the needs of TI B and TI C, they could be GST-free on the basis that they are the companies that effectively use or enjoy the services.[217]

Australia = Country B or C: If Australia were Country B, it is clear that the law would apply inappropriately. The place of taxation for Service 2 would be Australia, because although the customer is BAC A in Country A, the services are provided to another entity in Australia, BAC B and are effectively used by BAC B in Australia. Thus, the supply could not be treated as GST-free..[218] Moreover, Service 1 would be partly connected with Australia, because it is performed in Australia by BAC B.[219] As with Service 2, this part of Service 1 would not be GST-free because it is provided to TI B in Australia. Thus, subject to registration thresholds, BAC A would be required to be registered in Australia and to pay GST in relation to part of its supply to TI A CP. Service 5 would also be treated as a taxable supply because of its performance in Australia.

Thus, for the relevant part of Service 1, the Australian GST determines the place of taxation inappropriately and not according to the Main Rule. In the case of Service 5, it is correct to treat Australia as the place of taxation, but the collection mechanism (registration of TI A CP) is incorrect, as the supply should be reverse charged. However, for this supply, the voluntary reverse charge mechanism could be used. This analysis would be the same if Australia were Country C. It should also be noted that all of the companies would be entitled to register for GST in Australia and to reclaim any GST incurred.[220]

These problems would not arise in New Zealand because direct delivery of Service 2 to another entity in New Zealand does not preclude zero-rating if the other entity is a registered person. Similarly, the place of performance proxy in New Zealand's place of supply rules does not apply to Service 5 because the customer is a registered business. Instead, consistently with the recommended approach, the reverse charge would apply to TI B, unless it were suspended because TI B would be entitled to 95% or more of the input tax credits. There is, however, a theoretical issue with that part of Service 1 that is performed in New Zealand,

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217 GST Act 1999 (Aus), s.38-190(1) item 3, as affected by s.38-190(4). That this is the Commissioner's view is confirmed in GST Ruling GSTR 2007/2, above note 38, at para 65 and Example 64 at paras 599-619.

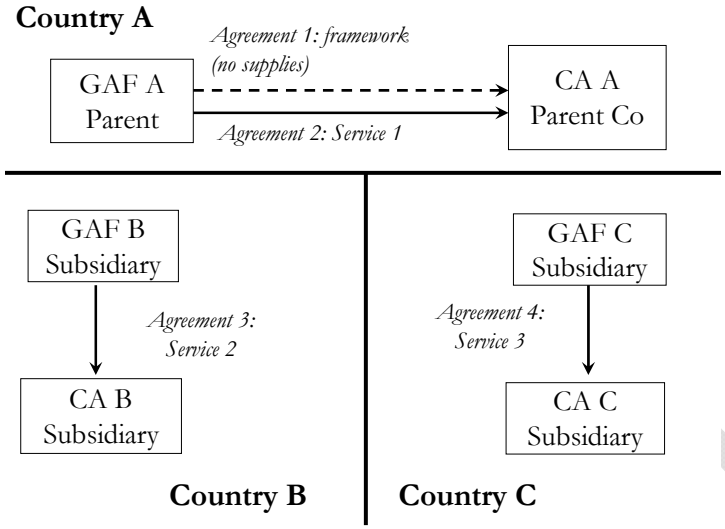
218 GST Act 1999 (Aus), s.38-190(1), items 2 and 3, and s.38-190(3), See the views of the Commissioner of Taxation in GSTR 2005/6, example 2, paras 288-296 and GSTR 2007/2 Example 32, p.98.

219 See, for example, GSTR 2007/2 para 562 and example 65 at p.137 and GSTR 2005/6 example 48 at paras 762 to 787

220 This conclusion presumes that the services acquired are not used to make input taxed supplies.

because TI A CP is not a registered person, though it seems likely that New Zealand would simply ignore this, given that it has no jurisdiction over BAC A and TI A CP and given that no New Zealand revenue is lost.

Example 2: Local agreements under common framework agreement[221]



Example 2 involves a situation where two parent companies in Country A (GAF A and CA A) enter into a framework or umbrella agreement, which sets out the terms and conditions under which supplies between members of the two groups will be undertaken. The facts specify that no actual supplies are made under Agreement 1, which merely sets terms that may be incorporated into subsequent agreements. Three separate agreements are then entered into. Agreement 2, between the two parent companies, incorporates the framework conditions and Service 1 is performed under that agreement. GAF B and CA B in country B enter into agreement 3, under which Service 2 is performed, and a similar arrangement takes place in Country C.

This example does not involve cross-border transactions. Despite the involvement of companies in three jurisdictions, and the incorporation of the framework terms into Agreements 2, 3, and 4, each service is supplied between a supplier and recipient in the same country. By applying the Main Rule, it is clear that the place of taxation for each agreement is determined by the customer location, which happens to also be the supplier location.

Although the Consultation Paper does not spell this out, in such circumstances, where all the supplies are domestic, it should not matter what actual rule the relevant country uses for enforcing place of taxation, so long as that rule has the effect that the place of taxation is the customer location and not somewhere else.

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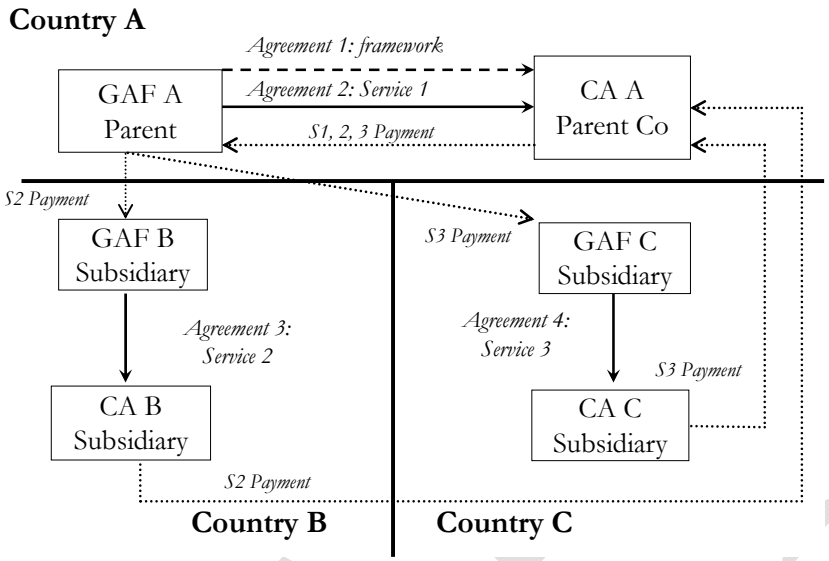
221 Second Consultation Document, above note 183, p.8, entitled 'Alternative global agreement' in the document. Again, I have taken a minor liberty with the diagram by specifying that no supplies are made under the framework agreement. This corresponds to Example 49 in GSTR 2005/6 at para 789 to 810 and Example 66 in GSTR 2007/2 at p.138

Australia: The Australian law clearly achieves this result. Each of the supplies would be seen as a supply 'connected with' the country in which the supplier and customer are located, and none of the supplies would be seen as exported.

Example 3: Example 2 with centralised payment arrangements[222]



Example 3 differs from Example 2 in that the services continue to be supplied in the same way and under the same agreements, but the payments are co-ordinated centrally. For the purposes of discussion, it is presumed that this does not create supplies between the CA group members.[223] CA A collects the payments from CA B and CA C, and passes them on to GAF A, who passes them on to GAF B and GAF C. The objective of this example is to show that the flow of payments in global groups might not always reflect the flow of the transactions. The payment flows do not change the place of taxation analysis.

Australia: The Australian law is consistent with this result. It is worth noting, however, that in practice it will not always be simple to clearly identify the supplies being made and the parties to those supplies, especially where the agreements are complex and the flows of payments, performance of the services, and contractual obligations in relation to the services each point in different directions.

Example 4: Example 2, with additional supply under framework agreement[224]

Example 4 varies little from Example 2. The only difference is that there is a supply made by GAF A to CA A under the framework agreement, consisting of co-ordination services in relation to the supplies made by GAF A's subsidiaries to CA B and CA C. This service, like the separate service made under a separate agreement between GAF A to CA A, has its place

222 Second Consultation Document, above note 183, p.10, entitled 'Alternative global agreement – different flow of payment' in the document.

223 The document also states that all payments are made on the same day, presumably to avoid any financial services being said to arise: ibid, p.11.

224 Second Consultation Document, above note 183, p.12, entitled 'Alternative global agreement – supply under a framework agreement' in the document.

of taxation in Country A. The coordination service relates to services performed in Countries B and C, but that does not make either country its place of taxation.

Australia: As in example 2, the Australian law clearly achieves the correct result.

5.2.a. Conclusions to be drawn from the Second Consultation Document

The Second Consultation essentially confirms the conclusions of the First, but adds the following points:

- the earlier conclusions are not affected by the use of more complex supply chains and business structures;[225]

- that physical rendering of a service to a business other than the customer (the contractual recipient of the supply) does not displace the Main Rule.[226]

These conclusions must nonetheless be read in light of the disclaimers noted earlier, in particular that they apply to genuine B2B transactions, and it may be that there are some circumstances where these conclusions are displaced, in particular for B2C transactions or in cases of evasion or avoidance.

6. The way forward for Australia?

Although the OECD Consultation Documents do not at this stage have the status of guidelines, there is a clear indication in the documents that some aspects of the Australian GST law are likely to need review. In particular, the over-inclusion of non-residents in Australian GST in the context of B2B transactions is self-evidently inconsistent with the conclusions reached to date. The application of Australian GST in the global agreement considered in the Second Consultation Document is cumbersome and unnecessary, given that the same result could easily be achieved without taxing services supplied to non-residents and without requiring registration for GST in relation to services supplied between two non-residents who are not carrying on their enterprises in Australia. This has been a cause of concern since GST was first introduced and there is no reason why it should not be addressed now, rather than waiting for final conclusions to be reached by the OECD.[227]

If a further conclusion can be drawn from the documents issued to date it is that any exceptions to the Main Rule are likely to be particular, rather than general. That is, it seems highly likely that, in deciding when to apply a proxy other than the customer location, there will be at least some degree of specification of the services to which the exceptions might apply. In this respect, the Australian law might also need to be modified, though at the present time there is no way of predicting how and to what extent it should change, since the exceptions have not yet been considered.

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225 Second Consultation Document, above note 183, p.13, para 28, points (1) & (3).

226 Second Consultation Document, above note 183, p.13, para 28, point (2).

227 I have been recommending changes along these lines for at least 7 years, see Millar, R, 'GST-free Exports of Services', presented at the ATAX 13th Annual GST Conference, Noosa, April 2001.

If changes were to be recommended, they would be these:

1. **Reverse charge:** Merge Divisions 83 and 84 and apply the reverse charge mechanism for all B2B supplies by non-residents who are not registered or required to be registered for GST and who do not make their supplies through an enterprise carried on in Australia;

2. **Connected with Australia:** Prevent the unnecessary inclusion of non-residents in the Australian GST by excluding B2B supplies performed in Australia from the place of performance proxy and instead taxing such supplies (if at all) under the amended reverse charge provisions. This could be achieved by excluding B2B supplies by non-residents from the registration threshold if they are connected with Australia only because they are performed in Australia.[228]

3. **GST-free exported services:** Limit the operation of the exceptions to the Main Rule by applying the *provision to another entity in Australia* proxy only to B2C transactions (where C means any entity that is not registered for GST).

These changes would bring Australia's coverage of cross-border transactions more closely into alignment with the more practical approach used in New Zealand. At the same time, non-residents would still have the option of being registered and remitting GST on such supplies, an option they could choose to exercise if they incur otherwise unrecoverable Australian input tax.[229] Unlike New Zealand, the option for non-residents to register would not depend on the agreement of local customers.

If these changes were made, Australia's law would apply correctly in all of the situations considered in the OECD Consultation Documents to date. In addition, they would also protect the Australian revenue because under the current law, the round tripping rules and connected with Australia rules operate in combination to make it difficult for the Commissioner of Taxation to collect GST on the value added by non-resident suppliers who choose not to comply. Were the law to be changed as suggested, such GST would be collected through the reverse charge mechanism from Australian entities from whom the Commissioner can more effectively enforce his power to collect.

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228 The same approach has already been taken when Australia modified its place of taxation rules for foreign tour operators: specified supplies (both B2B and B2C) of rights to acquire something in Australia and rights to commercial accommodation in Australia are excluded from the registration threshold calculations when not supplied through an enterprise carried on in Australia: GST Act 1999 (Aus), ss.188-15(3)(c) & 188-20(3)(c).

229 It might be that ultimately the OECD guidelines will require Australia augmenting its generous approach to non-resident registrations either by providing a separate refund system for non-resident businesses, or by allowing simplified registration and return procedures, but at this stage the work on this aspect of guidelines has not begun.