Indirect Tax Partners

James Robinson of Indirect Tax Partners sets out some initial thoughts and views on the recently published documentation relating to Base Erosion & Profit Shifting by the OECD and the interaction with Value Added Taxes.

This morning, the OECD released a number of different papers that primarily focus on the extensive, and some would say, long overdue reform of global direct tax policies and procedures.

The OECD, alongside the G20 and other associate countries, has a number of different Actions and Deliverables and this article focuses on Action 1 and the 2014 Deliverable on the subject of "Addressing the Tax Challenges of the Digital Economy[1]".

It should be noted that the OECD also has a Global Forum on VAT[2] running in parallel to the Base Erosion and Profit Shifting Project ("BEPS"). This Forum of over 100 participants is working to review the OECD International VAT/GST Guidelines and this has a wider scope from an indirect tax perspective than BEPS. The Forum was primarily focused on reducing double taxation and under-taxation in trade for both B2B and B2C cross border transactions.

Why is VAT in the scope of the BEPS Project?

It took me a while to get to my own answer, but in my view it should not be for the following main reasons:

1. Indirect taxes in general are way ahead of direct taxation in terms of relevance to the digital economy we live in today.
2. Shifting the place of taxation is generally more difficult for indirect taxes than it is for direct taxes.
3. The areas of perceived weakness for indirect taxes have, in substance, been the same for years and nothing to do with the relatively more recent issue (or perceived issue) of BEPS.
4. The transactions that the BEPS Project is focused on are already covered by today's indirect tax legislation and in my mind, should every recommendation under BEPS be implemented tomorrow, indirect tax reporting and compliance would carry on as normal.

So the challenge that the OECD faces by including VAT and other indirect taxes in the BEPS Project deliverables is that the objectives of the two taxes are so diametrically opposed, a solution for one is unlikely to be a solution for the other. On face value you would think that this appears to not be the case – both want to remove non-taxation of either profits or transactions for example. However, the background and scope of perceived abuse of the non-taxation issues are just not equal. The vast majority of B2B transactions are subject to tax in one place or another when it comes to VAT – to say therefore that non-taxation is a material concern seems odd.

There are some obvious examples where clear non-taxation in the VAT world does occur. The lack of reverse charge on imported services into Singapore; transactions involving EU VAT groups and branch structures (we'll see where *Skandia* goes with that); arbitrage using place of supply of services rules between two jurisdictions (think cross border yacht leasing); as well as a few others. However, I do believe that the instances of non-taxation in the B2B world are relatively insignificant in terms of overall values when compared to the amounts of income tax not paid globally each year (through the legally operated tax structures in place).

Evasion has to be outside the scope of the BEPS Project and the Forum and so any argument that starts with "tax avoidance is legal tax evasion" or similar words is instantly disqualified from participating. Legal structuring for both direct and indirect taxes occurs every day in every country in the world – as it should given the number of tax professionals, businesses and other stakeholders who are interested in legally and responsibly lowering their overall tax burden.

What is said about VAT?

In overall content terms, very little, but this hasn't stopped the OECD from still throwing the odd curve ball and two very wild pitches. In my mind, the majority of transactions

[1] http://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en

[2] http://www.oecd.org/tax/consumption/vat-global-forum.htm

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in the world today could have been handled efficiently by VAT legislation from a decade ago. That didn't seem to come into play with OECD so let's examine each of their key VAT points one by one. Warnings will be given where the reader may be required to sit down due to the extreme nature of the words published.

Up front, the paper starts with some good commentary on what the OECD believes the Digital Economy to be. Their use of phrases such as "continuous state of evolution" and "rapid technological progress" are all true, but I'm not sure if they noticed that this digital world has been in existence for a relatively long time. The underlying technology that supports our digital world has improved[3], but the actual type of services and goods that move through it have, for all intents and purpose, remained unchanged since the early 2000's.

The Exempt Sector

The first business sector to be mentioned in VAT terms is the Exempt Sector and the perceived risk that it is using the Digital Economy to "avoid or minimize the amount of unrecoverable VAT they incur on the inputs used for their exempt activities". I see no specific link between the Digital Economy and Exempt businesses undertaking VAT structuring. Since the dawn of time, Exempt businesses have been undertaking planning on all aspects of their business, including procurement, sales channels, customer contracting and internal legal structuring to reduce VAT costs. I see no real reason as to why this specific sector gets called out by the OECD and it almost feels as if they had to find something to put in here. Further commentary in section 5.3 of the paper on the Exempt sector does nothing to really justify the specific targeting.

The Consumer Sector

Next up in the firing line are Consumers and their egregious behavior when using the internet to find the lowest price product or services through the use of global sourcing (or what I would call effective household budgeting). Taxes play an important part in setting consumer pricing for online vendors, but let's be fair here – Amazon started in 1995, eBay in 1995, iTunes in 2000 – and apart from having a mobile interface that is better looking and works faster, nothing has changed in terms of the overall VAT supply chain for these huge global ecommerce businesses. Governments that have high values set for their Import Reliefs on tangible goods (Australia is around AU$1,000) and/or no requirement for non-established vendors to register and pay VAT on downloaded B2C services have only themselves to blame that no taxes are being collected on the transactions that the OECD states are undermining domestic businesses and creating tax revenue losses.

Only 32[4] countries around the world have an "effective" mechanism for dealing with cross border sales of digitized services to private consumers. The EU has had its rules since 1 July 2003 and they could be implemented on a global basis tomorrow to fix the perceived lack of taxation the OECD describes. However, it is the OECD and its members that seem to not want to implement, or that they have greater priorities. The Working Party No. 9 of the OECD CFA has said that they'll get to this by the end of 2015 in what is described as a "pressing issue that needs to be addressed urgently to protect tax revenue and to level the playing field". I'm going out on a limb here, but this has been an issue since 2000 so while I commend the efforts of the WP9 group, I, along with many other tax professionals with whom I have discussed this, can't actually figure out what would stop them doing something about this so called huge problem today.

Collection of VAT

Having broadly alienated most people on the planet in early sections, the paper (at section 7.6) examines in a little more detail the types of transactions that they are concerned about under the broader challenges raised by the digital economy – low value import relief and remote digital supplies to consumers. As noted above, their words are too little, too late. The tax regulations that apply to these transactions have never materially changed – with the exception of the EU in 2003 and 4 other countries in the last 15 years.

The points made in respect of low value relief are so ridiculous it becomes farcical. No more than three paragraphs apart, the OECD even explains why these import limits <u>must</u> exist and then goes on to come up with phrases such as "inappropriately low amount of VAT is levied" and "increasingly controversial". At this point, I would simply tell each OECD member country to put their

[3] See figure 1 for improvements in mobile data speeds - http://mobiledevdesign.com/learning-resources/lte-s-last-hurdle-testing-time-ethernet-mobile-backhaul

[4] 28 Member States of the European Union, Switzerland, Norway, Iceland and South Africa.

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big boy pants on and lower the value on which relief is available. It isn't a difficult decision and one that the UK did through simple legislative change in 2012[5] on specific imports where VAT avoidance was becoming increasingly obvious. If countries consider that they are relatively close to the breakeven point (cost of collecting the tax becomes equal to the tax collected) then this subject is closed. It isn't a difficult or complex discussion so let's not make it one.

I'm saving the most controversial piece of today's information release till the end, but in second place comes the commentary relating to cross border B2C supplies of digital goods and services. The most damning line in the entire document is on page 136:

"Compliance with these requirements is essentially voluntary as the consumers' jurisdictions have limited means to enforce compliance by non-resident non-established suppliers"

The requirements referred to in this sentence are those in place today in the 32 countries that have elected to tax certain B2C transactions in the country where the consumer belongs. With these twenty-one words, the OECD lost all credibility with me. First up, this is tax evasion - that's right I went there and used the "e" word. The OECD describes evasion as:

"a term that is difficult to define but which is generally used to mean illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities."[6]

So using the OECD's own definition, it seems fine for evasion to take place as cross border tax enforcement is difficult. At this point, I was convinced that BEPS and VAT needed to be separated and that while solutions may need a compatibility test, the OECD had simply not understood what the true digital economy issues were for taxpayers around the world.

The solutions therefore put forward are neither new or in my mind will actually solve the challenges identified. The OECD had the opportunity to take a big step forward in respect of VAT and other consumption taxes, but simply failed to do so. Down the line, progress I think will be made, but there needs to be a different way of identifying the issues; agreement on global principles; and enforcement. I suspect retirement will be upon me before any of this happens and yet the technology and legislation exists today that would allow for a simple and effective solution that pushes tax revenue to the right tax authority in a timely and easy to comply manner.

As promised, the following may make your eyes water and head hurt so please consider yourself duly warned. On a final note, and this can be found at section 8.2.1.5, a potential option for direct taxes would be to tax websites based on bandwidth used. I truly didn't know if this was a genuine statement or whether like many other hoax news stories that often appear on 1 April each year, this was a joke that had been accidently inserted into the final draft by mistake. In either case – genuine or joke – I can't actually recall a more unrealistic idea since PwC decided to spin off its consulting arm and call it Monday[7]. I'll let readers

Conclusion

BEPS is essentially a politically driven initiative and runs the risk of unnecessarily dragging VAT through the Court of Public & Political Opinion as it moves forward.

Let's hope not, but the future is not bright.

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5 http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/news/removal-lvcr.htm

6 http://www.oecd.org/ctp/glossaryoftaxterms.htm#E

7 http://www.techrepublic.com/article/monday-pwc-consultings-new-name-creates-controversy-cackles/