Overview and current state of play - EU VAT Action Plan and OECD VAT/ GST developments

27 August 2018

In brief

Back in 2016, under their 'Better Regulation' agenda, the European Commission adopted a 'VAT Action Plan' in order to "reboot the current EU VAT system to make it simpler, more fraud-proof and business-friendly". Since then, the global VAT landscape has continued to change dramatically. Navigating the transformation of the EU VAT regime, alongside many other countries introducing or modifying their own indirect tax regimes, is a significant challenge for multinational businesses. As this period of change continues, businesses must be prepared for how this impacts their own evolving models, operations and structures.

Key elements of the EU's VAT Action Plan have now been agreed (E-commerce Package, December 2017; Administrative Cooperation, June 2018) or are under discussion (Definitive VAT Regime Proposals, published in October 2017 and May 2018). Looking at these developments, not only is this an unprecedented moment in EU VAT history with so many different proposals in play at the same time, but the measures themselves carry potentially far reaching consequences for businesses trading across the EU.

Indeed, when looking at the bigger picture in a wider global context there is a clear trend. On the one hand, the spread of VAT (or 'goods and services tax' (GST) as it is known in many countries), continues apace with more countries either in the process of, or considering implementation. Since France in the 1950s, VAT systems have now been implemented in over 165 countries around the world. On the other hand, it is evident that VAT law has not kept up to date with commercial developments, particularly when it comes to how best to collect VAT in the context of modern supply chains. Recognising that jurisdictions would benefit from principles that contribute towards ensuring that VAT systems interact consistently so that they facilitate rather than distort international trade, the OECD launched and continues to lead (with government, academic and business representation) an ongoing project to develop international VAT/ GST guidelines as the basis for a common international VAT/ GST framework. There are a number of specific projects in train.

The rapidly digitalising economy is one key issue driving the agendas of individual countries and therefore the EU and OECD. As a destination-based consumption tax, VAT is better suited to addressing elements of this in comparison to Corporate Income Tax (CIT). However, there are a number of issues creating ongoing and in some cases significant uncertainty, distortion of competition, and revenue loss.

In addition, the speed and scale at which countries around the world are announcing changes to their VAT systems in order to address these challenges is giving even the biggest and best-resourced businesses a serious headache. This likely will continue in the coming months and years as policymakers find themselves under enormous pressure to establish ways to tax the digital economy in the short term, whilst in the longer term develop sound policies that safeguard VAT revenue, ensure a level playing field between local and foreign suppliers and foster economic growth.

This Tax Policy Bulletin considers the background to some issues of particular concern to businesses, how EU Member States are focusing resources on addressing them (both collectively and unilaterally) and how the OECD is seeking to ensure global consistency. In order to meet the growing number of challenges, businesses should consider how best to develop a forward-looking tax strategy, including active involvement in the VAT policy space.

In detail

Background

For some time now the Commission has been concerned with the significant EU 'VAT gap' - the difference between expected annual VAT revenue and VAT actually collected by Member States each year. According to the latest estimates (2015), the VAT gap stands at €150 billion. Of that amount, missing trader fraud alone is estimated to account for a VAT revenue loss of around €50 billion per annum. At the same time, the Commission has recognised that the current VAT system is too complex and fragmented (i.e., unharmonised), and creates significant administrative burden for businesses, particularly those at the smaller end of the spectrum.

The Commission's Action Plan is intended to set a pathway to modernise the current EU VAT rules, including:

- central design principles for a future single EU VAT system (the 'Definitive VAT Regime')
- short-term measures to tackle VAT fraud
- an updated framework for VAT rates, and greater flexibility for Member States in setting their own rates
- modernised and simplified VAT rules for e-commerce in the context of the EU's Digital Single Market Strategy, and
- a comprehensive VAT package to make life easier for small or medium-size enterprises (SMEs).

Key elements of the VAT Action Plan have now been agreed (E-commerce Package, December 2017; Administrative Cooperation, June 2018), or are under discussion (Definitive VAT Regime Proposals, October 2017 and May 2018).

At the same time, looking at the bigger picture in a wider global context, particularly in respect of the digital economy, many countries have changed or are changing their rules to apply VAT/ GST at the place of consumption in much the same way as the EU has already done for telecoms, broadcasting and electronic services (TBE services), and is now introducing for goods. Therefore, the OECD work in agreeing global standards is instrumental in tackling the difficult task of modernising VAT/ GST systems, and the materials produced by the OECD form an ever expanding sounding board built on global consensus. These include:

- the International VAT/ GST Guidelines, which set (non-binding) international standards for the treatment of international trade in services and intangibles
- the BEPS Action Item 1 report on 'Addressing the Challenges of the Digital Economy'
- the report on 'Mechanisms for the Effective Collection of VAT/ GST When the Supplier Is Not Located In the Jurisdiction of Taxation', and
- a project regarding the 'Role of Digital Platforms in the Collection of VAT/ GST on Online Sales'.

As a destination-based consumption tax, VAT/ GST is better suited to the rapidly digitalising economy, certainly in comparison to CIT. However, countries are turning toward a complex mix of different measures to address apparent shortcomings and/ or the need to quickly generate more revenue. Indeed, national measures and technological innovation seem to be catching up with, if not yet overtaking, many of the proposals or discussions -perhaps robust, streamlined and data-rich systems and processes could form a viable alternative to complex and untested structural reform.

Observations: Many governments in the EU (and around the world) are taking unilateral administrative measures to assert more control over their national VAT systems. The speed and scale at which countries around the world are announcing changes to their VAT systems in order to address current challenges is creating headaches for even the biggest and best-resourced businesses. Policymakers are seeking to develop sound policies that safeguard VAT revenue, ensure a level playing field between local and foreign suppliers and foster economic growth. However, they continue to find themselves under enormous pressure to establish ways to tax the digital economy in the short term.

EU Definitive VAT Regime

Far-reaching reform proposed

Under the umbrella of its 2016 Action Plan on VAT, in October 2017 the Commission published an eagerly awaited communication document, together with a series of legislative proposals for the far-reaching reform of the EU VAT system with two key aims: to make the EU VAT system more robust against fraud, and to make it simpler for businesses trading cross-border in the Single Market.

The package of measures towards what the Commission calls 'a single EU VAT area' or 'Definitive VAT Regime' is intended to replace the transitional arrangements entered into in 1993. In effect, the proposals seek to treat the business-to-business (B2B) intra-community supply of goods as a single transaction (abolishing the existing symmetry of dispatches and acquisitions). The proposals also seek to broaden the current system in place for business-to-consumer (B2C) Telecommunication, Broadcasting and Electronic (TBE) services to the B2B supply of goods. This framework is accompanied by certain mitigation measures and simplifications (i.e., certified taxable person status and so-called 'quick fixes') on the journey towards the long-term aim for all supplies to fall under the Definitive VAT Regime. This eventually would include services as well.

As a first step, the 2017 proposals set out (at a high level) the fundamental legal cornerstones, or building blocks, on which to construct the future VAT system. A second step followed in May 2018 when the Commission published a detailed legal proposal to amend VAT Directive 2006/112 (the VAT Directive) with a host of technical measures to operationalise the Definitive VAT Regime. Putting the legal cornerstones into operation requires a huge raft of legal changes - of the 400 or so articles in the EU VAT Directive, around 200 would need to be adapted or removed to implement the changes. The main elements of the Commission's latest proposals, which will require the agreement of all Member States, are discussed in the sections below.

Single supply for VAT purposes to replace the current dual system

The current (transitional) system of dispatches and acquisitions which splits a single supply into two elements for VAT purposes (a zero-rated dispatch in the Member State of origin and a taxable acquisition in the Member State of destination) would be replaced by the concept of a single 'intra-Union supply of goods' linked to the transportation of the goods and to be taxed in, and at the rate of, the Member State where the transport of goods ends. This would ensure equal treatment between domestic transactions and intra-Union transactions.

Observations: Whilst there is widespread support for the Commission's ambition to modernise, simplify and strengthen the EU VAT system, the Definitive VAT Regime proposals would represent a major reform for both governments and business.

- For Member States, they would need to put their faith in an untried and untested approach that is radically different from the way they currently administer the tax. It would see an estimated additional €600bn per annum flowing through the VAT system, and would rely on Member States to collect tax on behalf of each other at an even greater level than under the current Mini One Stop Shop (MOSS) system.
- In addition, whilst the proposals target domestic missing trader fraud, there is no guarantee that the Definitive VAT Regime would prevent other new forms of VAT fraud, including cross-border missing trader fraud.
- For businesses, they would need to understand and maintain the correct VAT rates for their products in all Member States. Further, there would be a significant negative impact on cash flow since, unlike the present reverse charge system that, for the most part, merely requires a customer to book offsetting VAT accounting entries on acquisition, under the Definitive Regime cash would need to change hands (i.e., the customer would actually need to pay the VAT over to the supplier and wait to recover it, just as if it were a domestic transaction).
- Finally, it is not clear whether emerging national administrative measures such as real time reporting, e-invoicing and split payments would also apply to foreign businesses collecting local VAT.

Collection mechanism depends on Certified Taxable Person (CTP) status

Whilst the supplier would in principle be liable for the VAT payment in the Member State of arrival of the goods, there is an exception: where the supplier is not established in the Member State of taxation and the customer is a CTP – think the VAT equivalent of the customs concept of Authorised Economic Operator (AEO). In this case, the customer would be liable to pay the VAT due by way of a reverse charge in the Member State of arrival.

CTP status would be available for a taxpayer making intra-Union supplies, where they can demonstrate:

- the absence of any serious or repeated tax and customs infringements and serious criminal offences
- a high level of control, and
- evidence of financial solvency.

Observations: The CTP concept aims to limit the amount of additional VAT flowing through the new system – potentially critical given the eye-watering figure of €600bn previously mentioned. However, it appears to be administratively burdensome, potentially difficult to qualify for (e.g., start-ups, non-EU established entities and entities making exempt supplies would all seem to be ineligible), impractical to implement uniformly and then monitor across all Member States, as well as complex to program into ERP systems for VAT determination purposes in order to cater for transactions with both CTP and non-CTP customers. Therefore, in the short term, this simplification measure likely would bring its own complexity to the system.

Quick fixes

In addition to the CTP cashflow benefits of reporting VAT via the reverse charge procedure, a number of quick fixes would also be available to CTPs to improve the functioning of the current VAT system whilst work on the definitive VAT arrangements for intra-Union trade is ongoing. This would include:

- simplification and harmonisation of rules regarding call-off stock arrangements where goods are transferred between CTPs
- simplification of rules in order to ensure legal certainty regarding chain transactions where both supplier and intermediary are CTPs
- harmonisation and simplification of rules for CTPs on the proof required to exempt an intra-Community supply of goods from VAT, and
- the VAT identification number of the customer being recognised as a substantive condition in order to exempt an intra-Community supply of goods from VAT (NB: this requirement is not linked to CTP status).

Observations: Given the complications associated with the proposed CTP regime, during Council negotiations Member States moved to decouple the quick fixes from the CTP proposals in order to accelerate short-term progress on these much needed measures. Furthermore, interposing a CTP requirement makes little sense when Member States already apply a number of cross-border simplification measures that (although largely unharmonised) work well without any form of accreditation. Therefore, CTP status will now be considered along with the other Definitive VAT Regime proposals according to a longer time frame.

The result is that this could potentially lead to political agreement of the quick fixes in the Council sometime in 2018, their implementation into Member State national VAT legislation in 2019, with the new quick fix regulations taking effect by late 2019 or 2020.

That said, according to a very recent development (June 2018), a number of Member States have requested the addition of a fifth quick fix to implement an exemption for cost sharing groups (CSGs) for financial service activities. This follows the Court of Justice of the EU's (CJEU's) restriction of the application of the exemption for CSGs (under Article 132(1)(f) of the EU VAT Directive) back in 2017. Whilst Member States appear to agree unanimously on the four original quick fixes, this new development risks derailing the quick fix timetable since not all Member States favour the approach, and the Commission may be unwilling to accept further instances of Member States taking the lead in proposing legislation - under EU law, the Commission alone has the right of initiative (see below under 2021 E-commerce Package changes for online marketplaces). Therefore, Austria, which has now taken over the Presidency of the Council from Bulgaria, will have to make further progress on this issue in due course.

Expanded One Stop Shop (OSS) and other proposed changes

Outside the CTP regime, the supplier would report and pay the VAT due using a simplified OSS registration. This would:

- Cover B2B sales of goods and allow for the collection and payment of VAT in the Member State of establishment according to the rules of the Member State of arrival (i.e., the place of consumption). The Member State of establishment would then distribute those revenues to the Member States of arrival, thereby simplifying registration and compliance obligations.
- Be available to taxable persons not established in the EU, under the condition that they appoint an intermediary that is established in the EU. The intermediary would be liable for the VAT payment and for

fulfilling the obligations included in the scheme in the name of, and on behalf of, the non-EU established taxable person represented.

- Allow for input tax deduction, subject to certain conditions and the provision of additional VAT return information.
- Require monthly OSS VAT returns for traders with an annual EU turnover in excess of €2,500,000.
- Ensure the proper monitoring of the payment and deduction of VAT, by issuing an invoice that would be mandatory for all intra-Union supplies of goods. The invoicing rules of the Member State in which the supplier is established, or identified, would apply.
- Harmonise the time of supply rules for intra-Union supplies.
- No longer require recapitulative statements (European Sales Lists) for Intra-Union supplies of goods. However, the obligation would remain in place for services.

Timing

As noted above, the quick fixes are likely to take effect by late 2019 or 2020.

The implementation date for the Definitive VAT Regime has been delayed by six months to 1 July 2022.

Observations: Although delayed, the start date of 1 July 2022 still may be an unrealistic target. This is undoubtedly a much longer term project (policymakers all seem to agree on this point), similar to the 2010 VAT Package, or the 2015 place of supply rule changes for TBE services. In addition, the 2021 E-commerce Package OSS will need to be in place and functioning smoothly, well before the OSS could be expanded again to cope with the Definitive VAT Regime.

Another important point to keep in mind is that the ability for Member States to apply zero and reduced VAT rates is linked to the current transitional regime. If the Definitive VAT Regime were to replace the current system, the legal basis for these non-standard rates would also disappear (see Article 402 of the EU VAT Directive). This places significant emphasis on the Commission's VAT rates proposal, which is intended to reshape the EU VAT rates regime whilst allowing individual Member States the right to continue applying their current VAT rate derogations. In light of the intensely political nature of any negotiation concerning rates, reaching agreement in this area will be no easy task.

In recognition of the overall complexity, Member States apparently are reluctant to move forward at pace on the proposals. So perhaps we should see the Commission's proposition merely as a starting point in the discussion rather than an end in itself. However, whilst reaching agreement on such a profound overhaul will prove difficult, political pressure can accelerate timelines and overcome technical impasses. Thus developments in this area require continued close attention as well as input from businesses – there has never been a better opportunity for business involvement in the policymaking process, as legislators search for innovative solutions to overcome complex obstacles.

Therefore, the Commission requested views on the proposals via a public consultation that lasted from 25 May 2018 to 24 August 2018.

Unilateral administrative changes

National measures and technological innovation seem to be catching up with, if not yet overtaking, the Commission's proposals. For example, many governments in the EU (and around the world) are taking unilateral administrative measures to assert more control over their national VAT systems (see table below) looking into areas such as real time reporting and enhanced e-invoicing, VAT split payments, following financial flows rather than physical flows, and even experimenting with using distributed ledger technology via the blockchain.

Real time reporting
Spain - effective 1 July 2017, data to be provided within four calendar days from the date of issue of the invoice
Hungary - effective 1 July 2018, immediate supply of information
Italy - effective 1 January 2019, mandatory e-invoicing - all relevant invoices have to be issued and submitted to the Italian Tax Authorities' (SdI) e-invoicing platform

SAF-T & other reporting requirements
Austria - SAF-T introduced in 2009
Belgium - Transactional Network Analysis (TNA), sharing cross-border VAT information gathered from automated data mining
Czech Republic - Monthly VAT control statement introduced in 2016
France - SAF-T (FEC) introduced in 2014
Italy – Quarterly VAT control statement introduced in 2017
Lithuania - SAF-T introduced in 2016
Luxembourg - SAF-T introduced in 2008; Transactional Network Analysis (TNA), sharing cross-border VAT information gathered from automated data mining
Netherlands - TNA, sharing cross-border VAT information gathered from automated data mining
Portugal – SAF-T introduced in 2008
Slovak Republic - Monthly VAT control statement introduced in 2014
UK - Making Tax Digital project to digitise VAT reporting from April 2019
Split payment (customer pays VAT directly to the government or into the supplier's dedicated and ring-fenced VAT account)
Italy - introduced in 2015
Poland - introduced in 2018
Romania - introduced in 2017
UK - considering use of split payment for online marketplace transactions

Observations: Given how quickly the world is changing, it might be preferable to further examine whether the aims of the Definitive VAT Regime can be achieved through the use of technology and by harnessing the power of data - i.e., the extent to which the deficiencies of the existing EU VAT system could be resolved via the implementation of more effective enforcement systems and controls built on modern technology and deployed at scale across the EU.

EU E-commerce Package

Background

Whilst the Definitive VAT Regime is a response to particular (although not unique) EU problems associated with trading across a single market, the E-commerce Package deals with issues that are more universal in nature. Thanks to the explosion of cross-border trade in an increasingly globalised economy facilitated by the internet and constantly evolving technological innovation, the world has become a smaller, highly interconnected global village.

Moreover, the pace and magnitude of change has exposed glaring holes in the EU, and worldwide, VAT system that governments have desperately been trying to close over the last two decades. The intensity and extent of government reaction to this new economic environment has now reached a tipping point that is difficult to keep up with for even the most sophisticated companies.

Rewinding to the turn of the millennium, new rules regarding the VAT treatment of the supply of electronically supplied services (ESS) were specifically introduced for non-EU providers in 2003, with a requirement to register and account for local VAT in the Member State of consumption. Whilst the 2003 rule change addressed the prior loss of EU VAT revenue on ESS provided by non-EU suppliers, it was not until much later that EU businesses were subjected to the same approach - since 1 January 2015, and with no registration threshold, there is an obligation for all B2C suppliers of TBE services to register for and charge VAT in the Member State of consumption, with an option to report and pay the VAT due via the simplified MOSS registration regime. For the sake of completeness, B2B transactions, on the other hand, are subject to self-assessment (reverse charge) by the customer, thereby reducing the administrative burden for government and business alike.

The ESS/ TBE rules bring a host of complexity, instances of which are well documented. These include: difficulties in identifying and evidencing customer location and status, as well as burdensome registration, invoicing and data storage requirements (i.e., burdensome when applied simultaneously across multiple countries, each with different national practices). The MOSS itself is not universally loved, despite its worthy aim, since due to overly formalistic rules it is not as simple to use nor as risk free as businesses would like. That said, generally speaking, the 2015 developments are viewed as a great success, particularly by those Member States now enjoying an influx of new VAT revenue. However, given the areas of complexity and administrative burden noted above, and in order to further modernise and simplify cross border e-commerce VAT rules, which have so far left untouched the VAT treatment of the B2C sale of goods facilitated by the internet, the Commission proposed a number of measures that the Council adopted in December 2017 for phased implementation over the coming years, in 2019 and 2021.

Observations: Other taxes are also beginning to feel the force of a shifting landscape as more transactions move online. Most recently (June 2018), in the South Dakota v Wayfair case, the US Supreme Court overturned the 1992 case of Quill Corporation v North Dakota. The Quill case precluded states from requiring interstate retailers to collect and remit sales and use tax on sales made to in-state customers unless the retailer had a physical presence in the state. Several key themes emerged during the arguments, including the Court's uncertainty as to whether the physical presence requirement is a diminishing issue and how burdensome tax collection and remittance would be if economic presence rules were applied instead. This historic ruling changes the landscape of sales tax collection for remote sellers and has potentially far-reaching implications. The US may be one of the few countries still holding out against introducing a VAT system, but it seems that certain concepts already considered in the context of VAT, including how to determine the place of taxation, are catching on.

EU Provisions effective from 2019

The 2019 rules include a variety of simplification measures:

- a €10,000 threshold will be introduced for businesses providing B2C intra-community TBE services
- home country invoicing rules will be introduced for businesses using the MOSS
- businesses with a turnover below €100,000 will be able to rely on only one piece of evidence in order to determine customer location, and
- the MOSS will be available to non-EU businesses making occasional supplies of TBE services.

Observations: the 2019 rules are largely sensible and represent a good outcome for SMEs currently finding it difficult to engage in cross-border e-commerce in a VAT compliant manner. For SMEs trading via online platforms, these MOSS improvements may have limited impact since the platform is deemed to act as principal in providing TBE services to the end customer (i.e., the platform itself is responsible for meeting the more significant VAT compliance obligations, rather than the actual supplier). However, overall, the measures show that policymakers are listening to business concerns, and this seems to be the direction of travel - the introduction of far-reaching new concepts and their subsequent refinement in light of the experience after a number of years.

EU Provisions effective from 2021

By contrast, the 2021 changes are more radical and include:

- the €10,000 threshold implemented via the 2019 simplification measures (see above) will be extended to cover B2C intra-community supplies of goods as well as TBE services. This will replace existing distance selling thresholds
- extension of the MOSS to B2C intra-community supplies of goods and all B2C services.
- removal of the low value consignment relief (LVCR) rules. NB: For simplification and cost collection reasons the EU exempts

from VAT the importation of goods not exceeding a total value of up to €22; many other countries around the world employ a similar practice

- the introduction of collection mechanisms for VAT on the importation of low-value goods including an Import One Stop Shop (IOSS)
- although it was not part of the initial proposal, high-level agreement was reached on the principle to make online marketplaces liable on:
  - B2C supplies of goods they facilitate up to a value of €150 where imported from non-EU countries
  - B2C supplies of goods of any value from non-EU countries where the goods are located in the EU at the point of purchase
  - requirement for online platforms to hold and provide information on supplies of goods and services they facilitate.

Observations: Whilst reaching agreement on the E-commerce Package was a significant achievement on behalf of the Commission, note that the 2021 changes were agreed at a political (rather than at a technical) level.

This means that further work is required to explore the detail and practical operation of the rules, and there are, to date, very few working examples or best practices around the world from which to draw valuable experience. Therefore, it will be critical for the Commission to engage widely with business when working on the detailed rules (i.e., when drafting an Implementing Regulation). This is particularly true given that Member States have brought some of the measures (e.g., extension of the scope to online platforms) into the Council negotiations with no prior business consultation and no impact assessment.

The intent to significantly lower the present distance selling thresholds for goods (currently set individually by Member States at a level of between €35,000 and €100,000 per annum) is likely to bring considerable increased administrative burden for businesses. Going forwards, many more suppliers will need to understand how their products are taxed in other Member States (i.e., at what VAT rate). Given the Commission's intention to grant greater flexibility to Member States to set their own rates, this could produce an even more complex landscape to follow.

In terms of the rules for the importation of low-value goods, the complexity inherent in this area is considerable, given the wide variety of new and constantly evolving business models with different parties of different sizes involved in the value chain performing different functions, the interaction with customs law, and questions around the cost effectiveness of enforcing the collection of VAT on low-value goods. First explored in some detail in the BEPS Action 1 report 'Addressing the Tax Challenges of the Digital Economy', a number of jurisdictions are now focused on taxing the B2C importation of goods facilitated by the internet. Australia has taken the lead in taxing the import of low-value goods (under A$1,000) as of 1 July 2018. The rules are complex as regards determining when they apply, to whom they apply, and how supplies which form part of larger consignments should be treated. There is also a requirement to provide detailed information for both GST and customs purposes. Time will tell whether or not these particular measures are a success (other governments are watching closely), but it is clear that on the one hand governments are losing vital tax revenue in this area (€5 billion estimated annual tax loss in the EU) due to the lawful application of LVCR rules as well as the unlawful abuse of LVCR rules by those undervaluing imported goods in order to fall within the scope of the relief. On the other hand, the LVCR rules give overseas' sellers a competitive advantage versus EU traders who have long been calling for a more level playing field. New Zealand is now proposing a similar offshore supplier registration model, with draft legislation due to be tabled in November 2018.

Again, timing is tight for implementing the new rules in the EU, but there is a backstop. If it does not seem probable that the implementing rules or IT infrastructure will be ready in time, the Commission will assess by the end of 2019 at the latest whether the 2021 go-live date can be adhered to.

Unilateral marketplace measures

Some Member States are already taking unilateral measures to safeguard the collection of VAT on sales enabled through online platforms, as set out below. These steps do not alter the place of taxation or create a new right of taxation (as we are seeing in some cases for CIT). Instead, they represent enforcement measures to ensure that a specific VAT liability owed is paid over to the national exchequer.

The UK has been very active over the last few years in legislating for marketplaces to take a greater interest in the VAT compliance of the traders using their platform. The UK introduced rules in 2016 and extended them in 2018 to make online marketplaces joint and severally liable for non-compliant traders selling goods to UK consumers through their platforms. The UK will also introduce the Fulfilment House Due Diligence Scheme in 2019 which requires fulfilment businesses to keep certain records and carry out robust due diligence checks on their overseas customers selling goods to UK customers via online marketplaces. Finally, the UK wants all online marketplaces operating in the UK to sign an agreement to ensure their sellers understand their tax obligations and to help tackle online VAT fraud and errors taking place on their platforms.

More recently, in May 2018, the Federal States of Germany announced a draft bill to place joint and several liability on marketplaces for non-compliant traders. It is possible that the new rules could be introduced with effect from 1 January 2019, although for the time being, this is very much a draft proposal and could be subject to significant changes before a final version is agreed. Clearly, though, countries are targeting platforms to assist more closely in the VAT collection process, on the basis that it is far easier to exercise control over a small handful of parties than a multitude of potential sellers.

Observations: In contrast to the UK rules and German proposals, the EU rules will place full liability on platforms for the supplies of goods they facilitate (i.e., the marketplace will be deemed to be in a buy-sell position for VAT purposes rather than acting merely as joint and severally liable agent in facilitating the supply of goods). Whilst this provides a potentially neat solution for VAT purposes at a conceptual level, the reality will mean more compliance obligations for platforms to attend to, notwithstanding the fact that platforms may lack structured data as to the exact nature of the items sold, the value of the items and any subsequent price adjustments, as well as difficulties in identifying the place of supply if the platform is not responsible for distribution and delivery.

OECD VAT developments

Background

When discussing the impact of digitalisation on the VAT world, it is impossible to ignore the OECD's contribution. In fact, the EU TBE rules and E-commerce Package proposals correspond with much of the work undertaken by the OECD over the last decade, including the framework set out in the OECD's highly influential International VAT/ GST Guidelines. Recognising the global spread of VAT (from France in the 1950s, VAT systems have now been implemented in over 165 countries) and that jurisdictions would benefit from principles that contribute towards ensuring that VAT systems interact consistently so that they facilitate rather than distort international trade, the OECD launched and continues to lead (with government, academic and business representation) an ongoing project to develop International VAT/ GST guidelines as the basis for a common international VAT/ GST framework.

Following the 2015 BEPS Action 1 report, many countries have changed or are changing their rules to apply VAT/ GST at the place of consumption in much the same way as the EU has already done. Therefore, the OECD work is instrumental in tackling the difficult task of modernising VAT/ GST systems, and the materials produced by the OECD form an ever-expanding sounding board built on global consensus, including those set out below.

International VAT/ GST Guidelines

The OECD's International VAT/ GST Guidelines set (non-binding) international standards for the treatment of international trade in services and intangibles. The Guidelines were adopted as a Recommendation by the Council of the OECD in September 2016, putting them on the same footing as the OECD's Model Tax Convention and Transfer Pricing Guidelines. According to the OECD's 'Tax Challenges Arising from Digitalisation – Interim Report 2018', to date over 100 countries have endorsed the International VAT/ GST Guidelines, and over 50 jurisdictions have adopted rules for the VAT/ GST treatment of B2C digital supplies in line with Guidelines. There is focus now on monitoring their consistent implementation - a critical aspect in a globalised economy.

BEPS Action Item 1 report

The BEPS Action Item 1 report on 'Addressing the Challenges of the Digital Economy' analyzes the challenges of VAT/ GST collection in the context of remote digital supplies to consumers and exempt businesses, as well as detailed analysis of the collection of VAT/ GST on the import of low-value goods.

Effective collection in the case of remote suppliers

The report on 'Mechanisms for the Effective Collection of VAT/ GST When the Supplier Is Not Located In the Jurisdiction of Taxation' examines and provides guidance on the collection of VAT/ GST on supplies of services and intangibles in cases where the supplier is not located in the jurisdiction of taxation, including a range of specific design features related to the implementation of registration-based collection regimes for non-resident suppliers as recommended by the International VAT/ GST Guidelines. It represents a vital resource for the consistent implementation of the framework set out in the Guidelines.

Digital platforms and online sales

The OECD is working on a project regarding the 'Role of Digital Platforms in the Collection of VAT/ GST on Online Sales'. It recognises the importance and complexity of the role of multi-sided platforms in the VAT/ GST system and focuses on two broad categories - the liability role (who should collect the tax) and the data-sharing role (can platforms support the VAT/ GST system in other ways such as providing data to assist in the tax collection process). Many governments are focusing on a full liability model, in line with the EU's E-commerce Package. However, this brings significant complexity and the commercial reality is that there is a wide variety of constantly evolving business models and, as a result, no 'one-size-fits-all' solution. It will be important to develop solutions that are effective from a tax collection perspective without negatively impacting the growth in this rapidly expanding market.

Observations: Whilst the OECD work is extremely important from the perspective of consensus building and is increasingly influential, the extraordinary rate at which VAT reform is taking place around the world has produced a wide variety of challenges for businesses operating in the global marketplace due to inconsistent implementation at an international level, even where governments have tried to keep compliance obligations for foreign vendors as simple as possible (e.g., by adopting simplified registration procedures). The result, even if overall the broad aims of the rules are similar, is a great array of legal and administrative practices established by different countries. Even simple and flexible rules can still result in significant complexity if every country applies its own particular brand of rules according to local culture, political imperatives and tax authority capacity.

As a result, we would note a number of best practices for the introduction of new VAT/ GST rules at both the global and country level:

More consistency is required internationally to ensure greater efficiency and cost effectiveness whilst safeguarding tax revenues. The EU and OECD, but in general all jurisdictions that operate a VAT/GST system, need to work together in order to achieve this. Benchmarking against OECD implementation guidance would help drive an even greater level of consistency and a greater chance of compliance in all countries.

In general, a simple and flexible tax regime (at least in terms of the way businesses are required to collect the tax) is key in order to help foster growth in the digital economy whilst simultaneously increasing tax revenues. With this in mind, early consultation with business is critical in order to understand how business works and, therefore, how best to draft the legislative and administrative framework. A number of countries have been proactive in adopting a consultative approach, but more could be done in this respect.

Once the legislative framework is finalised, sufficient lead time also needs to be set aside so that business and tax authorities are able to ensure full understanding of the proposals and make adequate preparations for implementing the rules. In particular, IT development projects are costly, resource intensive and need careful budgeting and execution. Again, some countries understand the need for sufficient transition periods, but many ignore this simple imperative in the face of political needs.

The takeaway

In the corporate income tax world change has started, as individual countries grow dissatisfied with the allocation of taxing rights under the longstanding, and recently strengthened, international tax framework in a digitalising world.

By contrast, in the VAT world, change has been a constant feature over the last 20 years, with VAT systems continually evolving to meet the relentless challenges of globalisation and digitalisation, particularly as regards the allocation of taxing rights – there has been a definite shift towards the destination principle as the system's keystone in determining the location of the taxing jurisdiction. The majority of developments, focused on collecting increasing amounts of VAT via businesses established outside the jurisdiction of consumption, has by and large been in line with the OECD's growing body of work. However, the accelerated tempo at which changes are being enacted and the extent of their impact are increasingly difficult for businesses to manage. We anticipate that at some point in the future there will be a move to consolidate and simplify the global VAT system using technology that will transform the collection of tax almost beyond recognition. However, for the time being, the steady march of new regulation is unlikely to abate anytime soon. Accordingly, businesses grappling with a proliferation of VAT compliance obligations have to find ways to deal with the growing burden in efficient and cost effective ways that do not overly influence or inhibit their commercial aims.

Therefore, living in an in-between time, where we can see the future but not yet touch it, there are a number of priority areas for businesses to consider:

- Being active in the VAT policy space is essential in order to ensure legislators and policymakers understand how business works and what role specific businesses can and cannot play in the tax collection process.
- Collaborating with legislators and policymakers – not just sharing practical information but working in partnership with government. Opportunities for working together are growing because easy answers are in short supply and governments need help to develop solutions that foster economic growth whilst safeguarding tax revenue. Getting involved early on in the process is critical in order to ensure maximum effect whilst minimising the impact of potentially adverse changes that could threaten both profitability and reputation.
- Developing a forward-looking tax strategy for meeting the growing number of compliance obligations, including whether the business has the right resources in the right place and what role technology and automation can play in increasing capacity. For many years, businesses have employed a strategy of implementing bolt-on IT solutions and patches to meet specific national VAT requirements – this no longer seems a tenable approach and more holistic solutions should be examined.

Let's talk

For a deeper discussion of how these issues might affect your business, please call your usual PwC contact. If you don't have one or would otherwise prefer to speak to one of our global specialists, please contact one of the people below:

Global Tax Policy Contacts

Stef van Weeghel, *Amsterdam*
+31 (0) 88 7926 763
stef.van.weeghel@pwc.com

Phil Greenfield, *London*
+44 (0) 20 7212 6047
philip.greenfield@pwc.com

Dave Murray, *London*
+44 (0) 7718 980 899
david.x.murray@pwc.com

Aamer Rafiq, *London*
+44(0)20 721 28830
aamer.rafiq@pwc.com

Edwin Visser, *Amsterdam*
+31 (0) 887923611
edwin.visser@pwc.com

Jo Bello, *London*
+44 (0) 7843 326017
jo.bello@pwc.com

Pam Olson, *Washington*
+1 (202) 414 1401
pam.olson@pwc.com

Will Morris, *London*
+1 (202) 312 7662
william.h.morris@pwc.com

Daniel Anghel, *Bucharest*
+40 742 394 208
daniel.anghel@pwc.com