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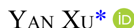
A MULTILATERAL OPTION FOR VAT IN INTERNATIONAL TRADE?


YAN XU*

Abstract Value-added tax, the most common form of consumption tax in the world, operates on a destination principle to ensure it is levied only in the place of final consumption in cases of cross-border transactions. The international trade in services and intangibles through digital means poses two challenges: finding the place of consumption and collecting the tax when services supplied by businesses in one jurisdiction are instantaneously consumed by customers in another. This article examines these challenges and considers how unilateral action and soft international responses have so far failed to achieve consistent destination basis taxation. An alternative option would be to adopt a hard multilateral response that would overcome the limitations of unilateralism and soft-law approaches and achieve consistent destination basis taxation in the digitalised economy.

Keywords: public international law, destination principle, VAT, unilateral actions, soft international law, multilateral treaty, international coordination.

I. INTRODUCTION

The growth of the digitalised economy has placed unforeseen pressures on all aspects of society, the economy, and the law.[1] States have reacted to these pressures as they have to all technological and economic developments—with a host of unilateral laws, anti-trust, intellectual property, tax, contract, tort and many others, which are inconsistent and often incompatible with those of others. It has yet to dawn on many policymakers that responses previously relied on are no longer suitable for an economy that transcends national borders and is truly global both in reach and in its underlying nature. Nor have they appreciated the extent to which the digital economic revolution will upend many of the domestic legal foundations on which societies are currently constructed. Most importantly, they have yet to realise that

* Scientia Associate Professor, University of New South Wales, yan.xu@unsw.edu.au.

[1] A broad definition of the digital economy is adopted by the G20 to reflect the fact that not only information and communication technology sectors but also traditional sectors have become integrated with the digital economic ecosystem. See The G20, *G20 Digital Economy Development and Cooperation Initiative* (5 September 2016) <http://www.g20.utoronto.ca/2016/160905-digital.html>.

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multilateral economic issues, just like multilateral environmental and health issues, require a multilateral response.

Nothing illustrates the need for multilateral responses to the challenges posed by the global nature of the digitalised economy better than the global adoption of value-added tax (VAT), the consumption tax designed to apply to the final consumption of cross-border sales of goods or services. The tax has been adopted by over 170 jurisdictions,[2] and has been the reliable, stable backbone of governmental revenues worldwide.[3] The tax was adopted at a time when international trade largely comprised tangible assets and was designed to be imposed as they physically crossed into the importing country. The drafters of VAT laws never conceived of an economic model based on digital goods and services supplied from a digital cloud, and the tax they designed had no collection mechanism that could be applied to supplies that were not stopped for border controls or checked by local tax authorities.

The widespread use of information and communication technology (ICT) has transformed global economies, and new business models, such as mobile payment services, cloud computing and App stores, have emerged.[4] Cross-border transactions in services and intangibles related to these new business models, together with traditional services enabled by ICT, have grown rapidly,[5] particularly during the global pandemic, and this trend is likely to accelerate.[6] The rise in suppliers selling globally through online platforms and the popularity of digital content supplies have a significant impact on VAT.[7] The tax, designed to be a levy on final consumption, was devised to suit the modes of twentieth century commerce, characterised by physical delivery and consumption of goods and services. A fundamental principle of VAT design is that the tax should fall on final consumption and thus be

[2] See the Organisation for Economic Co-operation and Development (OECD), *Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues* (OECD Publishing 2020) 12. Although the specific term used in jurisdictions can differ, the essence and nature of a VAT and a goods and services tax (GST) are identical. See also EY, *Worldwide VAT, GST and Sales Tax Guide 2021* (EY 2021) 259–60, 1623. For simplicity and convenience reasons, the article uses VAT to refer to VAT, GST, and similar taxes. Where the title of legislation, official documents and publications uses VAT or VAT/GST, the article uses that term rather than VAT.

[3] VAT has contributed about 20 per cent of total tax revenue on average in OECD countries. See OECD (n 2) 16; OECD, *Revenue Statistics 2020* (OECD Publishing 2020) 17. This is even higher in Africa, Latin America and Caribbean, and Asia and the Pacific. See OECD, 'Global Revenue Statistics Database', <https://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm>. The IMF notes an accelerated digital transformation of the economy post-pandemic as part of which VAT will be a vital and reliable revenue contributor to the post-pandemic recovery in many jurisdictions. International Monetary Fund (IMF), *World Economic Outlook, October 2020: A Long and Difficult Ascent* (IMF 2020) 25.

[4] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report* (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing 2015) (OECD BEPS Action 1) 54–63.

[5] World Trade Organization (WTO), *World Trade Report 2019: The Future of Services Trade* (WTO 2019) 6.

[6] IMF (n 3) 49–50.

[7] OECD BEPS Action 1 (n 4) 120–2.

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levied and collected where final consumption takes place.[8] Applying this destination principle to digital supplies where no physical property crosses borders is challenging.

There are also concerns of base erosion and profit shifting (BEPS) relating to cross-border digital supplies.[9] These concerns may be heightened when highly digitalised businesses structure their operations to pay little or no VAT on offshore digital supplies of services and intangibles. Highly digitalised businesses may be able to manipulate points of sale to minimise VAT liability,[10] making digital supplies through jurisdictions with low or zero VAT rates. Digitalised businesses in the services sector are particularly sensitive to VAT rates.[11] Concerns also arise regarding cross-border transactions involving businesses that do not need to be registered for VAT purposes (and file tax returns) but do not receive tax credits for any VAT paid.[12]

These challenges arising from the digitalised economy are not negligible. Existing legal systems are inadequate to sustain the development of the economy. Without effective rules and mechanisms to determine the place of consumption and for tax collection, the growth in cross-border digital supplies could result in loss of revenue and unequal tax treatment between domestic and foreign businesses. The global pandemic has led to soaring consumption of digital supplies of services and intangibles, making this of paramount concern.[13]

It is only over the course of much of the last decade, as the threat to national revenue multiplied,[14] that policymakers began to appreciate the challenges of

[8] See OECD, *International VAT/GST Guidelines* (OECD Publishing 2017) (OECD Guidelines) 15.

[9] The concerns are examined in OECD BEPS Action 1 (n 4) 82–4.

[10] M Olbert and C Spengel, 'Taxation in the Digital Economy – Recent Policy Developments and the Question of Value Creation' (2019) ZEW Discussion Paper No 19-010, 3. Imposing VAT based on where the supplier is located is called origin taxation. A few jurisdictions apply the origin principle to certain transactions, eg Brazil where exports are not zero rated in practice due to administrative barriers and limiting legal instruments. Cited in S Araújo and D Flaig, 'Trade Restrictions in Brazil: Who Pays the Price?' (2017) 32 Journal of Economic Integration 283, 288. See also OECD BEPS Action 1 (n 4) 83.

[11] M Olbert and A-C Werner, 'Consumption Taxes and Corporate Tax Planning – Evidence from European Services Firms' (2019) University of Mannheim Business School Working Paper.

[12] Those businesses are commonly called 'exempt businesses'. See K James, *The Rise of the Value-Added Tax* (CUP 2015) 58.

[13] D Mattioli, 'Big Tech Companies Reap Gains as Covid-19 Fuels Shift in Demand' (*The Wall Street Journal*, 29 October 2020) <https://www.wsj.com/articles/amazon-sales-surge-amid-pandemic-driven-online-shopping-11604003107>; 'Tech Giants' Profits Soar as Pandemic Boom Continues' (*BBC*, 27 July 2021) <https://www.bbc.com/news/business-57979268>; 'Google Search, YouTube Sales Soar to Record High in Covid-19 Pandemic' (*Business Standard*, 28 July 2021) <https://www.business-standard.com/article/international/google-search-youtube-sales-soar-to-record-high-in-covid-19-pandemic-121072800307_1.html>.

[14] For example, the estimated EU VAT revenue loss was around EUR 170 billion (2013) and EUR 150 billion (2016). European Commission, 'VAT Action Plan: Commission Presents Measures to Modernise VAT in the EU' (1 April 2016) <http://europa.eu/rapid/press-release_IP-16-1022_en.htm>; European Commission, 'VAT: EU Member States still Losing Almost €150 billion in Revenues according to New Figures' (21 September 2018) <https://europa.eu/rapid/press-release_IP-18-5787_en.htm>. In New Zealand, the lost GST revenue from cross-border

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applying a final destination tax when there is no identifiable border nor an obvious final destination. The result has been a hodgepodge of *ad hoc* responses that could easily result in double taxation or non-taxation.[15]

The international response to date has been underwhelming—there have been a handful of guidelines issued by the the Organisation for Economic Co-operation and Development (OECD),[16] to which most countries do not belong, and a skeletal academic literature produced.[17] The EU has been concentrating on internal mandatory rules and has largely ignored the broader international implications of the digitalised economy, whilst the United States (US), the only major economic power without a VAT,[18] is unsurprisingly indifferent to the problem.

Although a multilateral solution to the issues raised by the digitalised economy is not on the immediate horizon, it is not too early to consider this option. This article sets out why a multilateral approach is preferable and how this might be achieved.

Following this introduction, Part II examines the challenge of applying destination based taxation to cross-border digital supplies. Part III considers what individual jurisdictions have done to address these challenges and why such unilateral approaches cause problems. Part IV explores multilateral options for achieving consistency in the implementation of technical rules to meet the challenges. It canvasses two options: a soft international response in the form of non-binding guidelines, and a hard multilateral response in the form of binding treaties. It will be seen that the major problem is not the lack of technical solutions to the challenges but the lack of coordination mechanisms to enhance consistent implementation. It will be seen that soft international responses are unlikely to achieve consistency and that a hard international response is therefore to be preferred. Part V argues that there is a need for an internationally coordinated multilateral agreement that can facilitate consistent implementation.

services and intangibles and goods was estimated to be about NZD 40 million per year. New Zealand Inland Revenue, *GST: Cross-border Services, Intangibles and Goods* (Inland Revenue 2015) 5.

[15] VAT double taxation occurs 'where two states levy VAT on the same supply'. Situations that can give rise to this are when national rules determining the place of taxation differ, when the rules, albeit similar, are subject to either different legal interpretation or there is a different interpretation of the underlying facts, or when a supply is characterised differently. T Ecker, *A VAT/GST Model Convention* (IBFD Publications 2013) 35, 37–45. VAT non-taxation occurs 'when no country has imposed the tax on the relevant subject matter', which means no tax burden will be passed onto consumers. R Millar, 'Intentional and Unintentional Double Non-taxation Issues in VAT' (2009) Sydney Law School Legal Studies Research Paper No 09/45, 8. The non-taxation concerns the practical difficulty of collecting the tax, particularly if the customer is a final consumer unregistered for VAT purposes.

[16] The most important OECD guidelines are the OECD Guidelines (n 8). The OECD Committee on Fiscal Affairs developed the *International VAT/GST Guidelines* in 2006, with the latest version issued in 2017.

[17] See eg Millar (n 15); Ecker (n 15); Y Zu, 'Developing VAT Treaties: International Tax Cooperation in Times of Global Recovery' (2021) Legal Studies 1, 159–177 <https://doi:10.1017/lst.2021.37>.

[18] The US, however, does have state-level retail sales taxes.

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II. THE CHALLENGE OF VAT IN A DIGITALISED ECONOMY

The destination principle operates in a cross-border context, which means that VAT is 'ultimately levied only on the final consumption that occurs within the taxing jurisdiction'.[19] A uniform adoption of VAT laws based on the destination principle is neutral in that it taxes local and imported supplies in the same way,[20] and is combined with a zero rate for exported supplies together with a full refund of VAT paid by the exporter. However, this approach is difficult to apply to cross-border digital supplies because of difficulties in determining the place of consumption and, in the case of some foreign-sourced digital supplies, difficulties in collecting the tax.

The legitimacy of applying VAT to cross-border supplies depends on the nexus between the taxing jurisdiction and consumption,[21] in contrast to income tax where the nexus is the source of income or the place of residency of the taxpayer.[22] While all parties may agree that the place of consumption is the final destination of a supply or sale,[23] the practical application of this principle may be difficult. A customer viewing an image on their computer in jurisdiction A may consider that jurisdiction to be the place of consumption, whereas the supplier's jurisdiction may view the supply as taking place when the image is uploaded to the server and made available to customers.[24] Moreover, even if there is agreement regarding which is the taxing jurisdiction, there may be serious practical limitations on that jurisdiction's power to tax where supplies reach customers by way of ICT.[25]

In business-to-business (B2B) transactions, it may be necessary to determine the place of taxation (which should be the place of consumption) under each of the VAT laws involved. The difficulty of doing this varies, and the consequences of inconsistent determinations need to be considered. As VAT is intended to be a tax on final consumption, and not on businesses, intermediaries registered for VAT receive tax credits for any VAT paid, with

[19] OECD Guidelines (n 8) 15.

[20] ibid. 22.

[21] A Cockfield et al, *Taxing Global Digital Commerce* (Kluwer Law International 2013) 65.

[22] Under income taxation, the two nexuses overlap and two jurisdictions have the legitimate right to impose tax. The jurisdictions in question usually resolve the overlapping claims by way of a bilateral income tax treaty in which they agree to a division of taxing rights, with treaties usually based on either the OECD, *Model Tax Convention on Income and on Capital 2017* (OECD Publishing 2019) (OECD Model) or United Nations, *Model Double Taxation Convention between Developed and Developing Countries 2021* (United Nations 2021) (UN Model) or both.

[23] Allowing the destination country to tax creates a level playing field for all businesses in the same market.

[24] This is what happened in *R v Dawn's Place Ltd* (2006) FCA 349. In this Canadian case, the appellant, Dawn's Place Ltd, operated a website permitting the downloading of adult content images and video files on payment of a subscription fee. The contentious issue was whether the supply was made to the consumer at the point the copyrighted material was viewed or at the point at which it was made available for transmission.

[25] Cloud computing, for example, supplied by a business in one country to a customer in another will not be readily known to the tax authority of the other country since there is no 'border' in the virtual cloud.

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the final supplier remitting the VAT paid by the ultimate customer to the tax authorities, thus rendering VAT a tax on final consumption.

In a cross-border context, the ability of business customers to receive VAT credits encourages them to declare and self-assess VAT when importing digital supplies.[26] There are, however, businesses not entitled to claim credits for the VAT included in the cost of imported supplies and these businesses have no incentive to declare and self-assess a VAT liability. Businesses in this category include, for example, enterprises applying acquisitions to make financial supplies such as banks acquiring computer software used to make loans and unincorporated businesses acquiring supplies for the personal use of the proprietor.[27] A different challenge arises in the case of business-to-consumer (B2C) transactions where digital supplies are acquired over the internet or other telecommunication means, sometimes making it difficult for the supplier to identify exactly where the consumer is located.

Another challenge relates to collection. VAT is collected through a multi-staged process[28] through an invoice-credit method, under which businesses are taxed on their sales at each stage of production but obtain credits for the VAT paid on inputs.[29] As the tax is collected from business suppliers through multiple stages and, because of the credits available for businesses to deduct input VAT, the tax burden is actually borne by the final consumer. However, in an international context this staged collection process is disrupted, as the destination jurisdiction where consumption takes place may lack the means to collect the tax from the foreign supplier. The tax might be collected from the domestic customer registered for VAT purposes, such as a business. However, when both services and payment are executed seamlessly through the internet and other digital technologies, it is difficult to collect the tax from the customer, especially when the customer is the final consumer without any incentive to assess and remit the tax to the tax authority.

III. UNILATERAL RESPONSES

In recent years responses have been made by individual jurisdictions to these twin challenges of determining whether consumption has taken place within their territory and adopting mechanisms to impose and collect tax when the supplier is located abroad.

[26] James (n 12) 78–79.

[27] ibid 48. See also Millar (n 15) 10.

[28] OECD Guidelines (n 8) 14–15; James (n 12) 76.

[29] OECD Guidelines (n 8) 15. For a detailed discussion of the invoice-credit method, see James (n 12) 70–77. While the invoice-credit method is applied by almost all jurisdictions, another method, the subtraction method, is used by Japan. Under the subtraction method, VAT is levied on an accounts-based measure of value added determined as the difference between the value of purchases and the value of outputs. See LP Ebrill, M Keen and VJ Perry, *The Modern VAT* (International Monetary Fund 2001) 20–2.

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A. The Place of Taxation Rules

The first and foremost issue when applying the destination principle is where consumption takes place. Legal rules developed by jurisdictions for determining the place of consumption are often described differently, such as place of taxation rules, place of consumption rules, or place of supply rules.[30] The article uses the term 'place of taxation rules'.

The rules adopted are consistent neither in terms of style nor effect. The EU, for example, groups supplies into several categories (eg, supply of goods, supply of services, supply of services connected with immovable property) and provides specific place of taxation rules for each category of supply.[31] An alternative approach, adopted in some jurisdictions including Australia, New Zealand and Singapore, provides a series of rules to be applied in sequence until the place of taxation can be determined.[32] This iterative approach is viewed as a principle-based method for determining the place of consumption, and hence the place of taxation. The two approaches are not mutually exclusive and can be used in combination.[33]

Such differences in approach mean that there is a real possibility that consumption might either be double taxed or left untaxed. Coordinating responses within an economic union is relatively simple—common rules for VAT in Canadian provinces and in EU Member States provide clear examples—but achieving similar outcomes on an international level has proved more problematic.

[30] For example, the EU place of taxation rules differ between supplies of goods and supplies of services. For services, the place of supply determines the place of taxation. By contrast, New Zealand uses the place of supply rule as a first step to determine the place of taxation. Cockfield et al (n 21) 253–54.

[31] In the EU, from 1 January 2015, electronic services, telecommunications and broadcasting are taxed where the customer is established, has its permanent address or usually resides. Council Implementing Regulation (EU) No 1042/2013 (amending Implementing Regulation (EU) No 282/2011 regarding the place of supply of services) art 1 (see insertions of arts 24a–24f to Implementation Regulation (EU) No 282/2011). Specific place of supply rules are applied based on whether the supply is a B2B or B2C supply. Notably, art 24a applies to both B2B and B2C supplies, while art 24b applies only to B2C transactions. See Council Implementing Regulation (EU) 2017/2459 (amending Implementing Regulation (EU) No 282/2011) art 1 (adding specific requirements to art 24b of the Council Implementing Regulation (EU) No 282/2011)).

[32] In Australia there is no single place of supply rule, and instead one must consider the 'connected with the indirect tax zone' rules, the GST-free rules, the input tax credit entitlement rules, and the relationship with the concept of an enterprise carried on in or outside Australia. For a comparative discussion of the Australian and New Zealand place of taxation rules, see Cockfield et al (n 21) 258–60, 264–8. For Singaporean rules, see *The Goods and Services Tax Act* (Singapore Cap 117A) sections 13, 15. Digital services supplied by overseas suppliers to Singapore became taxable from 1 January 2020. Inland Revenue Authority of Singapore, 'GST on Imported Services', <https://www.iras.gov.sg/irashome/GST/GST-registered-businesses/GST-and-Digital-Economy/GST-on-Imported-Services/>.

[33] For a thorough analysis of the approaches, see R Millar, 'Echoes of Source and Residence in VAT Jurisdictional Rules' in M Lang et al (eds), *Value Added Tax and Direct Taxation: Similarities and Differences* (IBFD Publications 2009) 275–321.

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In an attempt to foster consistency in determining the place of taxation, the OECD recommend a set of general and specific place of taxation rules in the *International VAT/GST Guidelines* ('OECD Guidelines').[34] Under the general rule, cross-border B2B supplies use the customer location as a proxy to determine the place of taxation, while for cross-border B2C supplies, other than on-the-spot supplies, the location of the customer's usual residence is used.[35] For on-the-spot services, it is evident that the place of performance should be identified as the place of taxation because it is where consumption takes place.[36] The general rule for B2B transactions will apply in any situation.[37] This categorical application is to ensure that the tax is imposed and collected in the destination jurisdiction.

Specific rules under the OECD Guidelines, such as those on supplies involving movable or immovable property, are to be used only if and when the application of the general rules undermines neutrality, efficiency, certainty, fairness and effectiveness, and only when they are clearly specified in the relevant laws.[38]

Conceptually, these rules cannot always provide precise conclusions as to where the customer is located, particularly in B2C cross-border transactions, but rather can only estimate an outcome with reasonable accuracy.[39] Such limitations reflect the very nature of the digitalised economy, in which digital supplies of services and intangibles can be consumed anywhere via ICT. The 'proxy' approach may be needed in designing place of taxation rules for digital supplies, even though it can be arbitrary. On the other hand, the use of proxies to determine the outcome with reasonable accuracy meets the 'administrative ease' or efficiency objective in taxation, which requires that tax be collected with minimal administration and compliance costs.[40]

An increasing number of individual jurisdictions have taken measures to address this problem and achieve destination taxation.[41] These vary

[34] OECD Guidelines (n 8) Ch 3.

[35] ibid. Guidelines 3.2 and 3.6. In some circumstances where a supply is made to a business entity that has multiple establishments in different jurisdictions, an additional analysis is needed to determine which of the jurisdictions has the taxing right over the services. OECD Guidelines (n 8) 44–5.

[36] OECD Guidelines (n 8) Guideline 3.5.

[37] This is the case whether the supply of services will be further supplied onward by the customer to a third party or is instead directly provided to a third party or paid for by a third party. OECD Guidelines (n 8) 49–64.

[38] OECD Guidelines (n 8) 78–9. These specific rules are needed in those circumstances where using general rules could not achieve destination taxation.

[39] K James and T Ecker, 'Relevance of the OECD International VAT/GST Guidelines for Non-OECD Countries' (2017) 32 Australian Tax Forum 317, 360; Millar (n 33) 284.

[40] Such objective is considered a principle of good tax design. See, eg Commonwealth of Australia, *Australia's Future Tax System: Report to the Treasurer* (December 2009) Pt 1, 17; J Mirrlees et al, *Tax by Design: The Mirrlees Review* vol 2 (OUP 2011) 22; MP Devereux et al, *Taxing Profit in a Global Economy* (OUP 2021) 53–5.

[41] Cockfield et al (n 21) 235–374. The book notes rules and measures adopted by some earlier reformers such as Australia and the EU.

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considerably from jurisdiction to jurisdiction, though they are generally aligned with the destination principle.

In order to target digitally supplied services and intangibles, some jurisdictions have extended an existing general definition of 'services' in their VAT laws to include those that are supplied electronically by non-residents to domestic consumers, thus rendering them liable to VAT.[42] Others have developed a definition of digital services which aims to cover as wide a range of electronically supplied services as possible,[43] providing examples in a non-exhaustive list.[44] Some jurisdictions that initially adopted a relatively narrow definition have recently expanded it to include more types of digital services.[45] There are also jurisdictions which distinguish digital or the remote supply of services from non-digital supply of services, and provide a broad definition of the former, accompanied by examples intended to clarify but not to limit.[46] Digitally supplied services covered in the various definitions usually include ICT services (such as cloud computing) and ICT-enabled services (such as consultancy). While there appears to be a general convergence on a broad definition, the scope of what falls within it varies considerably.[47]

When determining the place of consumption, the proxy approach is usually adopted, but the details of this vary. Within the EU, for example, it was not until

[42] For example, Australia amended its GST law effective 1 July 2017 to impose GST on intangible supplies, such as supplies of digital content, games and software as well as consultancy and professional services, provided by foreign suppliers to Australian consumers. *A New Tax System (Goods and Services Tax) Act 1999* (Cth) sections 9–10(2)(b), 9–25(5); Australian Treasury, 'Tax Laws Amendment (Tax Integrity: GST and Digital Products) Bill 2015: Exposure Draft Explanatory Material' <https://treasury.gov.au/sites/default/files/2019-03/C2015-026_EM_Tax_Integrity_GST_and_Digital_Products.pdf>.

[43] For example, the EU VAT law defines electronically supplied services as those 'which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology'. See Council Implementing Regulation (EU) 282/2011 of 15 March 2011 (laying down implementing measures for Directive 2006/112/EC on the common system of value added tax) art 7(1). Similarly, Japan's Consumption Tax Act defines the provision of electronic services broadly with examples of included supplies and of exclusions. National Tax Agency (Japan), *Revision of Consumption Taxation on Cross-border Supplies of Services* (May 2015, revised December 2016) <https://www.nta.go.jp/english/taxes/consumption_tax/cross-kokugai-en.pdf>.

[44] Council Implementing Regulation (EU) 282/2011 of 15 March 2011, art 7(2). For Japan's rules, see National Tax Agency (Japan) (n 43).

[45] For example, in South Korea, digital services have been expanded to include advertising services, cloud computing, and intermediary online-to-offline services from 1 July 2019 (previously limited to 'content-oriented' transactions). KPMG, *VAT/GST Treatment of Cross-border Services: 2017 Survey* (KPMG International November 2017) (KPMG 2017 Survey) 7; KPMG, *Taxation of the Digitalized Economy: Developments Summary* (KPMG 22 July 2021) 141.

[46] An example is New Zealand. See *Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016* (effective 1 October 2016 for online services) sections 55 (introducing new section 8B, remote services, into the *Goods and Services Tax Act 1985* (NZ)) and 72 (introducing new sections 60C and 60D, electronic marketplaces, into the *Goods and Services Tax Act 1985* (NZ)). See also M Walpole and M Stiglingh, 'Untangling the Worldwide VAT Web on Digital Supplies' (2017) 32 Australian Tax Forum 429, 446.

[47] KPMG 2017 Survey (n 45) 7.

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2015 that the place of taxation for both intra-EU digital supplies of services and supplies from outside the EU became aligned with the jurisdiction of customer location, ie, destination taxation.[48] For B2C supplies, the place of taxation depends on the location of the customer, being either a place where the final consumer is established or has an establishment (if it is a non-taxable legal person) or a place of permanent address or usual residence (in the case of a natural person).[49] Suppliers are required to determine the customers' location on the basis of two pieces of evidence such as billing addresses, bank details, and IP addresses.[50] Simplified evidence requirements apply to small EU-established businesses.[51]

New Zealand also introduced rules in 2015 which require suppliers of remote services (ie services supplied from offshore jurisdictions) to use two pieces of evidence to determine when a service is supplied to a person resident in New Zealand.[52] The place of taxation rules are modified to tax remote services supplied to consumers resident in New Zealand.[53] A difference between the EU and New Zealand rules is that under the latter, suppliers of remote services are presumed to make sales to final consumers, ie B2C supplies, unless the recipient provides their Goods and Services Tax (GST) registration number or a New Zealand business number.[54] Several other jurisdictions have also implemented rules requiring evidentiary documentation to determine customer location.[55]

Other measures have been developed to solve this difficulty. In Japan, the place of taxation rules for the digital supplies of services were revised, also in 2015, to be the 'address of the service recipients',[56] ie the customer location. The Japanese rules seem to rely on a combination of subjective and objective methods to determine whether an address is in Japan.[57]

[48] Directive 2006/112/EC (of 28 November 2006 on the common system of value added tax) arts 44, 45, 58. Prior to 2015, intra-EU B2C supplies of digital services were taxed in the Member State of the supplier. See also Council Implementation Regulation (EU) No 1042/2013 (n 31) art 2.

[49] However, from 1 January 2019, the place of taxation has been modified to be the Member State of the supplier if the supplier is an EU-established business making B2C supplies of digital services as well as telecommunications and broadcasting, and the relevant supplies do not exceed a certain threshold. Council Directive (EU) 2017/2455 (of 5 December 2017 amending Directive 2016/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods) art 1(1) (see amendments to art 58(2) and (3)).

[50] Council Implementation Regulation (EU) No 1042/2013 (n 31) art 1 (see insertions of arts 24 (a), 24b(d), 24f Implementing Regulation (EU) No 282/2011).

[51] Council Implementation Regulation (EU) 2017/2459 (n 31) art 1 (see amendments to art 24b, para 2 of Implementing Regulation (EU) No 282/2011, effective from 1 January 2019).

[52] *Goods and Services Tax Act 1985* (NZ) (as amended 2016) section 8B(1) and (2).

[53] *Goods and Services Tax Act 1985* (NZ) (as amended 2016) section 8(3)(c). See also Cockfield et al (n 21) 244–5, 258–60. Those services were previously not taxed.

[54] *Goods and Services Tax Act 1985* (NZ) (as amended 2016) section 8B(5).

[55] KPMG 2017 Survey (n 45) 11.

[56] National Tax Agency (Japan) (n 43). Under Japan's *Consumption Tax Act*, if the place of supply is in Japan, the supply is taxable there. Previously the place regarding digitally supplied services was the location of the service provider.

[57] ibid.

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In contrast to the rules applied in other jurisdictions or the recommended place of taxation rules by the OECD, China's VAT rules generally mean that VAT liability arises if the supplier or the recipient of services is located in China.[58] Either will, *prima facie*, result in taxation in China, which would result in double taxation if services provided by a foreign supplier to a Chinese customer, or services made by a Chinese supplier to a foreign customer, were actually consumed overseas and that jurisdiction applies the destination principle. Special rules are therefore applied to prevent this.[59] VAT (with or without credits) is either exempted or excluded for exported services and intangibles when they are consumed 'completely outside China',[60] meaning that services supplied offshore should have no connection with any goods or real property in China and the recipient is outside China.[61]

The proxy approach may help address the difficulty in determining the place of customer location in the case of B2C supplies, but will be onerous where single transactions are conducted instantaneously. The difficulty could be compounded where jurisdictions use different proxies and evidence requirements. Where consumers use virtual private networks (VPNs) to acquire services or intangibles from offshore suppliers, foreign suppliers could be misinformed by the VPN when seeking to identify the consumers' location.[62] Moreover, notwithstanding the convergence towards imposing taxation in the place of customer location, jurisdictions differ in interpreting where that is. Disparities exist between the understanding of even seemingly simple terms such as 'business' and 'final consumer' and this has direct relevance to the application of the place of taxation rules in many jurisdictions, which depend on whether the customer is a business or a final consumer.[63] So far, however, there has been little coordination at the international level.

[58] *Provisional Regulations on Value Added Tax* (China) (as amended 2017) art 1; *Notice on Comprehensively Implementing the Pilot Reform of Replacing Business Tax with VAT* (Ministry of Finance and State Taxation Administration, issued 23 March 2016, effective 1 May 2016) (Caishui [2016] 36) Annex 1, art 12(1).

[59] Caishui [2016] 36 (n 58) Annex 4, arts 1, 2, 7.

[60] ibid Annex 1, art 13.

[61] ibid Annex 4, art 7. For analysis of China's place of taxation rules, see Y Xu, 'The Destination Principle in International Trade in Services: The Chinese Experience' in RF van Brederode (ed), *Virtues and Fallacies of VAT: An Evaluation after 50 Years* (Kluwer Law International 2021) 529–60, 544–5. While the determination in B2B supplies can be made based on the customer's business VAT registration information, for B2C supplies there are no specified proxies or presumptions available as a guide for foreign suppliers.

[62] A VPN is a secure tunnel between users' devices and the internet enabling data to be shared without impediment.

[63] KPMG 2017 Survey (n 45) 8. Some jurisdictions, such as Mexico and China, do not differentiate between B2B and B2C supplies. See EY (n 2) 1008; Xu (n 61) 546.

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B. Collection Mechanisms

The absence of physical border controls over cross-border digital supplies challenges tax collection. Alternative collection mechanisms are thus needed. Two have been commonly used to date, one for B2B sales and the other for B2C sales.[64]

The method used most often for B2B sales is known as the reverse charge or self-assessment mechanism. This mechanism overcomes the disruption of the staged collection process in a cross-border context, that is, the practical difficulty of collecting the tax from the offshore supplier on sales to domestic customers. When supplier and customer are located in different jurisdictions, the reverse charge mechanism shifts the tax collection from the supplier to the customer and the customer is required to account for and remit the VAT on the imported supply. Provided the customer is a registered business, it would be entitled to an offsetting credit for the tax at the same time the import VAT is reported,[65] although the credit is not available to some customers such as financial suppliers. No similar incentive exists in B2C supplies and thus the reverse charge mechanism is ineffective for VAT collection.[66] The foreign-vendor registration mechanism has consequently developed. Instead of shifting the VAT obligation to the final consumer, foreign suppliers are required to account for VAT and remit taxes from the consumer in the consumer's jurisdiction through tax registration.[67] A common approach is to adopt a simplified registration process to reduce compliance costs.[68]

Another collection mechanism in B2C transactions is to require online marketplaces or electronic platforms, such as Amazon Kindle, Apple App Store and Google Play, to account for VAT on sales of services and intangibles made by sellers through their platforms and to be jointly and severally liable for VAT.[69] The advantage of this approach is that these multi-sided platforms usually have a greater capacity to comply with VAT obligations required by various jurisdictions to which services and intangibles are sold, than individual players trading in the platforms.[70] It is also easier to regulate a few big platforms than to deal with a vast number of small business players. Particular attention is also required to the role

[64] Both mechanisms have been endorsed by the OECD; see OECD, *Mechanisms for the Effective Collection of VAT/GST Where the Supplier Is Not Located in the Jurisdiction of Taxation* (OECD Publishing 2017) (OECD Collection Mechanisms) 23, 36.

[65] The reverse charge mechanism is used in most jurisdictions to collect VAT in cross-border B2B transactions. KPMG 2017 Survey (n 45) 8. Jurisdictions using this mechanism are noted in EY 2021 (n 2) and KPMG 2021 (n 45). See also OECD Collection Mechanisms (n 64) 23.

[66] OECD Collection Mechanisms (n 64) 36.

[67] OECD Guidelines (n 8) 70–2.

[68] ibid 71–2.

[69] This mechanism is noted to have been adopted in some jurisdictions such as Australia and the EU. KPMG 2017 Survey (n 45) 20–1. See also OECD, *The Role of Digital Platforms in the Collection of VAT/GST on Online Sales* (OECD Publishing 2019) (OECD Digital Platforms).

[70] OECD Collection Mechanisms (n 64) 26.

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platforms can play in VAT collection in the sharing and gig economy which is comprised of an escalating number of small traders.[71]

A similar inconsistency exists with respect to the collection mechanisms. The mechanisms are usually differentiated between B2B and B2C supplies, with a reverse charge applying to the former and a foreign-vendor registration requirement to the latter. The EU adopts such an approach. Under EU rules, as with the determination of the customer location, evidence is required for the identification of the type of customer. In B2C transactions, foreign suppliers are required to register for VAT in the EU, without any threshold, and to charge VAT at the rate applicable in the customer's Member State. The EU has very recently moved to a simplified registration scheme to enable both EU- and non-EU-established suppliers of digital services to fulfil VAT reporting and collection obligations on consumption of all digital supplies made to other EU Member States.[72]

Similar mechanisms for B2B and B2C digital supplies are applied in other jurisdictions such as Australia. However, Australia's reverse charge rules for B2B supplies require the business customer, rather than the foreign supplier, to determine whether the imported services have been purchased for business use and must therefore apply the reverse charge.[73] For cross-border B2C supplies, foreign suppliers are required to register for GST, subject to a threshold.[74] The approach to using a threshold for foreign-vendor registration is also adopted in New Zealand,[75] but the threshold does not apply to cross-border B2B supplies because such supplies are out of scope in the tax law.[76] This use of thresholds to implement foreign registration mechanisms is common practice, but varies significantly by jurisdiction in monetary value and scope of supplies included.[77]

[71] OECD, *The Impact of the Growth of the Sharing and Gig Economy on VAT/GST Policy and Administration* (OECD Publishing 2021) (OECD Sharing/Gig Economy) 3–4, 41–85.

[72] European Commission, 'VAT One-Stop Shop', <https://ec.europa.eu/taxation_customs/business/vat/vat-e-commerce/new-oss-schemes_en>. The simplified registration scheme, called the 'One Stop Shop' system, has become effective from 1 July 2021, and it was a development of the previous Mini One Stop Shop system (effective 1 January 2015). See also EY (n 2) 509–11; KPMG 2017 Survey (n 45) 10.

[73] ATO, 'GST and Australian Businesses – Imported Services, Digital Products and Low Value Imported Goods', <https://www.ato.gov.au/Business/International-tax-for-business/GST-on-imported-goods-and-services/Australian-business-importing-goods-and-services/>. For reverse charge on imported B2B services, see *A New Tax System (Goods and Services Tax) Act 1999* (Cth) div 84.

[74] ATO, 'Non-resident Businesses and GST,' <https://www.ato.gov.au/Business/International-tax-for-business/Non-resident-businesses-and-GST/>. The registration is, nevertheless, a simplified system to assist foreign suppliers in fulfilling GST reporting and collection obligations in Australia.

[75] Inland Revenue (New Zealand), 'Supplying Remote Services into New Zealand', <https://www.ird.govt.nz/gst/gst-for-overseas-businesses/supplying-remote-services-into-new-zealand>.

[76] ibid. See also Inland Revenue, Policy and Strategy, *Special Report on GST on Cross-border Supplies of Remote Services* (Inland Revenue (New Zealand) 17 May 2016) 11.

[77] KPMG 2017 Survey (n 45) 9, 23, 25, 27.

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Although there is a tendency among jurisdictions to use the reverse charge in B2B supplies and foreign registration in B2C supplies to collect taxes, some jurisdictions have applied the single method of foreign registration to both types of supplies, while others have used an agency approach, requiring the foreign supplier to designate a local tax agent to file tax returns and collect taxes in B2C transactions.[78] There are also jurisdictions that do not adopt either mechanism but instead adopt a withholding mechanism. For example, China uses this method to collect VAT from cross-border B2B transactions where the foreign supplier has no Chinese business establishment or local agent. In this scenario, the Chinese customer is required to withhold and remit the VAT to the tax authority before final payment is made to the foreign supplier.[79] As the international norm is the reverse charge mechanism, with the importer responsible for the VAT in addition to the purchase price, foreign sellers to China have no way of recovering the withheld amount in their domestic jurisdictions. As a result, they would receive less than the agreed sales price, prompting them to charge Chinese business customers higher amounts than to customers in jurisdictions with a reverse charge system.[80] In these circumstances, the tax would act as a non-recoverable tariff for Chinese importers.

Lastly, the mechanism of using online marketplaces to collect VAT on B2C digital supplies has become increasingly common. Australia, the EU and New Zealand are among the first jurisdictions to require online marketplaces or platforms to register for and collect VAT on digital supplies of services, although the rules may differ.[81] Other jurisdictions, such as Mexico and Singapore, have followed suit.[82] Even within the US, where there is no VAT at the federal level, around 80 per cent of states require online marketplaces which meet specified state sales thresholds to collect the state-level retail

[78] For example, South Africa and Sweden (single regime of foreign registration) and Japan (tax agency). See KPMG 2017 Survey (n 45) 10, 58–9, 78; EY (n 2) 779–80, 1409–12; KPMG (2021) (n 45) 142; National Tax Agency (Japan) (n 43) 5.

[79] *Provisional Regulations on Value Added Tax* (China) (n 58) art 18.

[80] KPMG, *VAT and the Digital Economy in China* (KPMG 2016) 13, <https://assets.kpmg.com/content/dam/kpmg/pdf/2016/04/vat-and-digital-economy-in-china.pdf>. See also Xu (n 61) 558–9.

[81] For Australia's rules, see ATO, 'If You are An Electronic Distribution Platform Operator', <https://www.ato.gov.au/Business/International-tax-for-business/GST-on-imported-goods-and-services/How-to-charge-GST/If-you-are-an-EDP-operator/>; ATO, Law Companion Ruling LCR 2018/2, 'GST on supplies made through electronic distribution platforms'. For the EU rules, see Council Implementation Regulation (EU) No 1042/2013 (n 31) art 1 (see insertion of art 9 a to Implementing Regulation (EU) No 282/2011). The EU passed legislation, making online marketplaces responsible for VAT collection on distant B2C sales of goods with application from 1 July 2021. Council Directive (EU) 2017/2455 (n 49) art 2(2) (adding art 14a on electronic interfaces such as platforms to Directive 2006/112/EC). See also European Commission Taxation and Customs Union, 'Online Electronic Interfaces' <https://taxation-customs.ec.europa.eu/online-electronic-interfaces_en>. For the New Zealand rules, see *Goods and Services Tax Act 1985* (as amended 2016) s 60C. For the differences between the Australian and New Zealand rules and the EU rules, see KPMG 2017 Survey (n 45) 6.

[82] EY 2021 (n 2) 1008, 1346. The Mexican and Singaporean rules have become operative from 1 June 2020 and 1 January 2020, respectively.

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sales tax on sales they facilitate, including those related to services and digital goods.[83] Some similar, yet distinctive, approaches are used in other jurisdictions. In the UK, for example, online marketplaces are responsible for checking and reporting on compliance with VAT requirements by non-UK sellers registered on their marketplaces.[84]

Thus, various unilateral actions have been taken by jurisdictions to address the VAT challenges of cross-border digital supplies. Although the actions have largely followed the destination principle, global VAT systems are far from harmonised.[85]

IV. OPTION FOR MULTILATERAL RESPONSES

Unilateral approaches to the challenges raised by the operation of VAT in a digitalised economy have been only partially able to achieve the necessary harmonisation and reconciliation. In federal systems (or the EU), where multiple provinces, states or countries levy VAT separately, jurisdictions can agree to adopt harmonised legislation to address the challenges, but this solution only applies within the region. There are two possible paths to a true international solution: universal adoption of a soft international response in the form of non-binding international guidelines, or a hard international response in the form of a binding treaty.

A. *Soft International Response*

International guidelines have been developed in order to respond to the global VAT challenges in the digitalised economy.[86] Unlike income taxes, VAT was not subject to any internationally agreed standard until 2015 when the OECD Guidelines on international trade in services and intangibles were formally endorsed by over 100 participating jurisdictions and international organisations at the Global Forum on VAT.[87] The Guidelines were incorporated into an OECD Council Recommendation adopted in 2016, which was the first OECD legal instrument on VAT/GST and the first internationally agreed framework for the application of the tax to cross-

[83] KPMG (2021) (n 45) 149. The measure has been applied from 1 September 2019.
[84] ibid 145. The UK rules became effective on 15 March 2018.
[85] KPMG 2017 Survey (n 45) 19.
[86] The article uses the term 'international guidelines' to refer to those collective documents issued by the OECD in recent years and the term 'OECD Guidelines' to refer to the *International VAT/GST Guidelines*. The latter set up basic principles and a global standard for the VAT treatment of cross-border trade in services and intangibles, recommending place of taxation rules and collection mechanisms for jurisdictions to consider.
[87] OECD Guidelines (n 8) 4. The Global Forum participants include member countries and jurisdictions of the G20/OECD Inclusive Framework, OECD countries, 108 non-OECD jurisdictions including 67 developing economies, and a range of international and regional organizations. OECD, *OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors – April 2021* (OECD Publishing 2021) 16.

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border trade.[88] Given the acceptance of the OECD Guidelines by non-OECD member jurisdictions, they have a multilateral reach.[89] Subsequent international guidelines (which serve as implementation packages for the OECD Guidelines) have also achieved international acceptance.[90]

The various recommendations on taxation rules and collection mechanisms in the OECD Guidelines appeared in the report on BEPS relating to the digital economy.[91] The OECD Guidelines offered a technical solution for jurisdictions to consider in designing domestic rules to address VAT challenges. National laws to address taxation of cross-border digital supplies that were newly introduced or modified around that time are broadly aligned with the solution, demonstrating the influence of the OECD Guidelines on national legislation.

The intent of the OECD Guidelines was to facilitate a consistent approach to VAT taxation. As stated within the Guidelines, the objective is to 'facilitate a coherent application of national VAT legislation to international trade' and to 'minimise inconsistencies in the application of VAT in a cross-border context'.[92] This intention is endorsed in subsequent implementation packages, including guidance on collection mechanisms, the role of digital platforms in collecting the VAT on online sales, VAT policy and administration with respect to the sharing and gig economy, and model rules for platform reporting.[93] This series of guidelines is a direct response to the call for policy development to address emerging VAT issues and for coherent implementation from tax authorities of both OECD and non-OECD jurisdictions. The series also reflects the absorption of unilateral measures pioneered in early-mover jurisdictions. The series of international guidelines, particularly the OECD Guidelines, are the result of the collective effort of a wide range of jurisdictions confronting global VAT challenges presented by the ever-evolving digitalised economy.

So far 70 jurisdictions have aligned their national rules with the recommended solution under the international guidelines and around 40 further jurisdictions are moving towards alignment.[94] In theory, this should allow enhanced consistency with the implementation of destination taxation on cross-border trade in services and intangibles and avoidance of double

[88] OECD Guidelines (n 8) 4. For a comprehensive analysis of the OECD work from the lead-up to the 1998 Ottawa Framework Conditions to draft OECD Guidelines (2006–2013) and 2012 when the first Global Forum on VAT was held by the OECD, see Cockfield et al (n 21) 193–234; James and Ecker (n 39) 335–6. For the Ottawa Framework Conditions, see OECD, *Electronic Commerce: Taxation Framework Conditions* (OECD Publishing 1998).

[89] For the involvement of non-OECD countries, see James and Ecker (n 39) 336–38.

[90] The subsequent guidelines include OECD Collection Mechanisms (n 64), OECD Digital Platforms (n 69) and OECD Sharing/Gig Economy (n 71) as well as the model rules for platform reporting: OECD, *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing/Gig Economy* (OECD Publishing 2020) (OECD Platform Reporting).

[91] OECD BEPS Action 1 (n 4) 93–4, 120–9.

[92] OECD Guidelines (n 8) 3–4.

[93] OECD Collection Mechanisms (n 64) 3, 9; OECD Digital Platforms (n 69) 3, 10; OECD Sharing/Gig Economy (n 71) 3, 14; OECD Platform Reporting (n 90) 7.

[94] OECD (2021) (n 87) 16.

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taxation or unintended non-taxation. However, not all jurisdictions' VAT rules align with the guidelines.[95] Even if all jurisdictions follow the guidelines, inconsistent implementation exists due to differing interpretation and application in individual jurisdictions, and the lack of effective coordination to mitigate inconsistency. The constant call for consistency and coordination in the set of guidelines and considerable variations of national rules is revealed in large global surveys of VAT (or similar tax) systems.[96]

An illustration of the inconsistency problem occurs when determining the location where taxation should be applied where a B2B transaction occurs with a multiple location entity (MLE).[97] The standard rule is that VAT should be levied and collected in the jurisdiction of the customer location (a proxy for the place of consumption).[98] However, there is variability between jurisdictions as to the questioning process for determining that location in VAT laws. In the EU, the questions are what digital services are supplied, to whom the services are provided, why the services are supplied, and where and when the services are supplied. In contrast, the questions in Australia are whether services supplied are connected with Australia, whether they are supplied to Australia or from Australia, and whether the supply is GST-free (with input credits) or input taxed (exempt from the tax without input credits). In China, the questions pertain to whether the services supplier or recipient is located in China, whether the services are consumed completely outside China, and whether the supply is connected to any goods or real property in China. The questions are likely to differ again in other jurisdictions. Answers to the questions based on domestic place of taxation rules may lead to outcomes that contravene the destination principle in a cross-border context.

Consider the following scenarios. Company A, located in country A, concludes a contract for the provision of online training with company B, located in country B, for employees of company B's branch in country C. Company A invoices company B for the services and gets paid by company B. If country A is China, the services would be *prima facie* taxable in China since the services supplier is located in China as discussed above. However, if country B is Australia, the services would also be *prima facie* taxable in Australia as the services are connected with Australia, resulting in double taxation. In practice, the training services will be treated, under China's VAT law, as a supply that is exempt from VAT without input credits for the supplier, provided the services are consumed completely outside China

[95] KPMG (2021) (n 45) 79–153.

[96] See eg KPMG 2017 Survey (n 45) 6–13, 18–19, 21; KPMG (2021) (n 45) 80–153; EY (n 2) detailing 137 jurisdictions' specific rules on cross-border digital supplies of services and intangibles.

[97] An MLE is a legal entity with establishments in more than one jurisdiction. OECD Guidelines (n 8) 44.

[98] OECD Guidelines (n 8) Guideline 3.1 (destination principle), Guideline 3.2 (B2B supplies) and Guideline 3.6 (B2C supplies).

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and have no connection with any goods or real property in China.[99] However, except for China and a few other jurisdictions, many countries (country A) would treat the digital supply provided by company A as a zero-rated export, ie no VAT on the export with input credits for the supplier. Thus, there can be no double taxation from the perspective of country A *vis-à-vis* countries B and C, but there may be risks of double taxation or non-taxation if both or neither B or C regard the supply as consumed in their respective jurisdiction.

If country A is Australia, company B is in the UK and Canada is country C, the place of taxation would be determined as the UK (country B) as this is where the contract was concluded. Provided Australia zero-rates the supply and the UK company applies reverse charge (ie self-assess and pay VAT), the VAT chain is complete. Canada would not tax the training services as the Canadian branch did not make any acquisition. However, if country C, where the branch is located, is instead an EU Member State, the services would be taxed according to the effective use and enjoyment rule in the EU.[100]

Now if country B is China, the supply of the training services would be subject to China's VAT since the services recipient is in China. There will be a risk of double taxation if country C is an EU Member State because of the application of the effective use and enjoyment rule. China might exclude the training services from taxation if the tax authority can be persuaded that the actual customer of the services is outside China and the services have no connection to any goods or real property in China, even though the recipient who purchased the services under the contract is in China. If that is the case, there might be a risk of non-taxation if country C is Australia as the services would be an out-of-scope acquisition in its GST law and no reverse charge or tax would apply.

More complicated scenarios could arise with respect to cross-border digital supplies to MLEs. The OECD Guidelines offer three methods for jurisdictions to use to ensure destination taxation on supplies to MLEs, with the guiding principle that the taxing rights accrue to the jurisdiction(s) where the establishment(s) using the service or intangible is (are) located.[101] The more jurisdictions that adopt the same method, the greater the 'reduction in complexity, uncertainty and risks of double taxation and unintended non-taxation'.[102] Nevertheless, the flexibility allowed to individual jurisdictions to adopt the suggested methods, including the possibility that jurisdictions may not be prepared to adopt any method owing to the administrative and compliance complexities of the methods, suggest that the implementation of destination taxation in relation to MLEs is not consistent and the risks of both double and non-taxation are unlikely to be mitigated.

[99] Caishui [2016] 36 (n 58) Annex 4, art 2(3).

[100] Directive 2006/112/EC (n 48) arts 58, 59; Council Implementation Regulation (EU) No 1042/2013 (n 31) art 1 (see insertion of 24a(1) to Implementing Regulation (EU) No 282/2011).

[101] OECD Guidelines (n 8) Guideline 3.4, 44–9. The three methods are direct use, direct delivery and recharge methods.

[102] OECD Guidelines (n 8) 49.

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The inconsistency problem could be more pronounced in cross-border B2C supplies even if the recommended place of taxation rules are applied. This is because jurisdictions use different presumptions, have different requirements for the number and type of forms of evidence, and interpret what would be deemed as a B2C supply differently. To increase consistency, an alternative solution may be needed. As VAT is ultimately levied on final consumption, the place of taxation could be determined by following the cash-flow of the cross-border payment. The jurisdiction in which the financial institution or e-payment operator settling the payment is located would therefore be the place of taxation, unless evidence shows the consumption takes place outside that jurisdiction.[103] Continuing advances in technology and ever-increasing use of digital payment will enable the focus on cash-flow of cross-border payments to become a more reliable and manageable methodology to determine the place of taxation in B2C transactions. Hence, the 'follow the money' approach could be an alternative solution to the discrepancies in applying the destination principle.[104]

With regard to tax collection, while there has been a general convergence in the collection mechanisms, a substantial divergence in specific rules and procedures between jurisdictions has occurred.[105] Further, some potential solutions are not fully considered in the set of the international guidelines. An example is the withholding mechanism, an alternative to the more widely adopted reverse charge for B2B supplies which is a mechanism recommended in the international guidelines. Both the withholding and reverse charge mechanisms shift the tax collection obligation from the foreign supplier to the registered domestic customer and have the same effect when the customer is liable to pay the full amount of VAT and entitled to input credits on the tax paid. However, compared with a reverse charge, withholding would achieve better tax enforcement as it ensures effective tax collection, although it may cause the offshore supplier to bear the tax.[106] The relatively wider use of the reverse charge raises a question of whether the reverse charge is a one-size-fits-all method for B2B tax collection. The actual implementation of the reverse charge, while anticipated to result in efficient collection,[107] may in fact cause uncertainty, increased administrative burden

[103] The supplier in *Her Majesty The Queen v Dawn's Place Ltd* (2006) FCA 349 tracked the location of customers using their credit card bank information, a technique accepted by the court and the revenue authority (though the supply was found to have been made where the supplier was located and not the customer on other grounds, an outcome subsequently reversed by corrective legislation). See P Rendahl, *Cross-border Consumption Taxation of Digital Supplies* (IBFD Publications 2009) 283.

[104] ML Schippers and CE Verhaeren, 'Taxation in a Digitizing World: Solutions for Corporate Income Tax and Value Added Tax' (2018) 27 EC Tax Review 61, 67. The payment services providers can be used to help collect necessary information on cross-border transactions and to collect and remit taxes to the tax authority.

[105] For example, the reverse charge mechanism is widely implemented with rules varying considerably. See OECD Collection Mechanisms (n 64) 23; KPMG 2017 Survey (n 45) 18–19.

[106] KPMG 2017 Survey (n 45) 20.

[107] OECD Collection Mechanisms (n 64) 23.

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and potential risk of double taxation due to inconsistent rules and lack of bilateral agreements in VAT matters.[108]

Whether withholding could be an appropriate alternative to the reverse charge is not directly considered in the international guidelines, which might be due to the fact that no OECD countries use the mechanism.

Both the mechanisms have pros and cons. While it has the potential for better tax enforcement, withholding requires the foreign supplier to determine the customer's location at the time of pricing (which could be well before the time of the supply and the taxable event) to enable correct pricing, taking into account the amount of VAT to be withheld.[109] Under the reverse charge, in contrast, the foreign supplier is not required to determine the exact customer location before the actual supply, only whether the customer is an intermediate business or a final consumer. However, the reverse charge can be vulnerable to revenue risks.[110] Thus, to foster greater consistency in implementation, the international guidelines need to provide advice on the practice and rationale of the withholding system and, where individual jurisdictions choose not to utilise the reverse charge, a way of coordinating the two mechanisms.

For VAT collection in the B2C context, where jurisdictions have adopted the simplified registration mechanism, the use of the mechanism as well as the use of online marketplaces, appears to be effective in overcoming the collection challenges.[111] However, the lack of coordination arising from differences in domestic rules and concern over the incompatibility of the mechanism with domestic legal and regulatory systems has meant not all jurisdictions adopt the mechanism.[112] Improving consistency of implementation is not yet discussed in the guidelines.

B. Hard International Response

As shown above neither unilateral actions nor multilateral responses in the form of soft international guidelines (including the OECD Guidelines and the subsequent implementation packages) can create consistent implementation of rules and measures to address the VAT challenges arising from the digitalised economy. Therefore, a multilateral response that can effectively

[108] E Hadzhieva, *Impact of Digitalisation on International Tax Matters* (European Union 2019) 89.

[109] OECD Collection Mechanisms (n 64) 24.

[110] For example, when the customer, as a private consumer or an unregistered business, claims it is VAT registered and thus eligible for input VAT credits. ibid 24–5.

[111] OECD (2021) (n 87) 16. The report shows significant revenue yields in Australia (approximately EUR 618 million in the first two years), the EU (EUR 14.8 billion in the first four years), Russia (approximately EUR 241 million in the first two years) and South Africa (approximately EUR 436 million in the first five years).

[112] For example, in Japan, foreign registration may not be directly available for non-resident businesses. In China and Russia, currency controls require withholding be applied. KPMG 2017 Survey (n 45) 10, 20.

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coordinate the implementation of destination basis taxation at the international level can also be considered.

1. The status quo

To date, unilateral responses introduced by individual jurisdictions have largely focused on domestic taxation and collection issues. As such, they do not contribute to international coordination and offer no support for an internationally coordinated system to address the two VAT challenges in a consistent manner. In practice, unilateral actions have created more diversity than harmonisation.[113] Within the EU, cross-border coordination of national VAT systems has taken place to ensure taxes are levied consistently on a destination basis.[114] The EU VAT harmonisation, however, has, until very recently, focused more on intra-State transactions than trade with non-EU jurisdictions.[115] Outside the EU, there are only a few regional VAT coordination arrangements.[116]

The international guidelines have played a key role in building up a general alignment of national policy objectives with the guidelines, but they have not increased consistency of implementation. The problem may be partly attributed to the design features of domestic rules that are embedded in a jurisdiction's legal and regulatory systems as well as socioeconomic conditions. However, and perhaps more significantly, the inconsistency relates to a fundamental limitation of the guidelines, which recommend rather than direct. That is, the guidelines are no more than a soft law. They are flexible,[117] and provide jurisdictions discretion to decide the extent to which they wish to adopt recommendations, if at all. Unlike bilateral agreements on avoiding double taxation of income and capital (DTAs) or a multilateral

[113] Walpole and Stiglingh (n 46) 434–48.

[114] European Commission, 'Proposal for a Council Directive Amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States' COM (2017) 569 final (4 October 2017). See also KPMG 2017 Survey (n 45) 19–20.

[115] See eg E Verwaal and S Cnossen, 'Europe's New Border Taxes' (2002) 40 Journal of Common Market Studies 309–30; R de la Feria, 'The EU VAT Treatment of Public Sector Bodies: Slowly Moving in the Wrong Direction' (2009) 37 Intertax 148; C Breuer and C Woon Nam, 'VAT on Intra-Community Trade and Bilateral Micro Revenue Clearing in the EU' (2011) 9 eJournal of Tax Research 59; B Terra, 'Levying VAT in the EU Customs Union: Towards a Single Indirect Tax Area? The Ordeal of Indirect Tax Harmonisation' (2019) Erasmus Law Review 269.

[116] These are ANDEAN Harmonization of Substantial and Procedural Aspects of Value Added Taxes (Decision 599, 2004), UEMOA VAT Directive (1998, Directive No 02/98/CM/UEMOA), and CEMAC VAT Directive (1999, Directive No 1/99/CEMAC-028-CM-03). See Ecker (n 15) 69–70; LA Arias et al, 'The Harmonization of Indirect Taxes in the Andean Community' (2005) Inter-American Development Bank INTAL-ITD Occasional Paper-SITI-07; M Mansour and G-R Graziosi, 'Tax Coordination, Tax Competition, and Revenue Mobilization in the West African Economic and Monetary Union' (2013) IMF Working Paper WP/13/163, 10–12; World Bank, 'CEMAC Deepening Regional Integration to Advance Growth and Prosperity' (World Bank 2018) 48–50.

[117] KPMG 2017 Survey (n 45) 18.

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convention on preventing tax avoidance and evasion, the guidelines lack the necessary legal formality and cannot bind participating parties. They only recommend rules and mechanisms.[118] The flexibility afforded by the guidelines reflects concerns about national sovereignty, and, from a practical perspective, the non-binding feature allows the guidelines to be updated to accommodate continuing evolution in technological and regulatory fields. However, the flexibility offered for jurisdictions to adopt the rules in the guidelines may mean the efforts of inaugurating the guidelines to achieve consistency in tax enforcement would be to little avail. Risks of double taxation or non-taxation may not be effectively reduced as intended.

The role of the international guidelines in improving consistency may be further limited in four respects. First, the guidelines, in particular the OECD Guidelines, are considered 'extremely high level' and 'hedged with provisos'.[119] The various principles and recommendations are stated in general terms, leaving their interpretation and translation into specific rules to individual jurisdictions. This generality contributes little to the mitigation of significant discrepancies in defining, interpreting, and applying the destination principle across jurisdictions.[120] Second, the guidelines have only recently been published and their influence may not yet be fully recognised in those jurisdictions that have less cross-border trade in digitally supplied services. Third and relating to the second aspect, the guidelines, however relevant they may be to non-OECD jurisdictions, may not be achievable in those jurisdictions that lack the necessary administrative and compliance capabilities to give effect to them.[121] Additionally, there might be a concern of developing jurisdictions that the international guidelines do not sufficiently represent their interests and needs as they are developed by a group of developed jurisdictions. Implementing recommendations of the OECD Guidelines is a low priority when these developing jurisdictions consider tax reforms for the purposes of raising revenue and attracting foreign investment in an economically difficult time. Fourth, although the guidelines aim to align national VAT rules to the destination principle, they cannot completely reduce instances of disputes. It is not entirely clear whether the dispute resolution mechanisms, primarily the mutual agreement procedure currently available under DTAs on income and capital, is available to disputes in VAT matters.[122]

[118] OECD Guidelines (n 8) 11; OECD Collection Mechanisms (n 64) 10; OECD Digital Platforms (n 69) 9–10; OECD Sharing/Gig Economy (n 71) 14; OECD Platform Reporting (n 90) 7.

[119] R Millar, 'Looking Ahead: Potential Solutions and the Framework to Make Them Work' (2016) Sydney Law School Legal Studies Research Paper No 16/30, 16.

[120] ibid 16–17, noting that VAT laws are drafted based on different design principles with a wide range of different models to implement the destination principle.

[121] James and Ecker (n 39) 375–6.

[122] The mutual agreement procedure (MAP) is prescribed in art 25 of the OECD and UN Models on income and capital. It could be argued that the express statements in arts 24 (non-discrimination),

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The four problematic aspects of the OECD guidelines may be as important as their 'soft law' status in explaining why the guidelines have failed to produce sufficient harmonisation or consistency in the implementation of destination basis taxation in cross-border digital supplies. Even if the same guidelines were incorporated in a binding international treaty, the four issues would remain and many jurisdictions, particularly developing jurisdictions, would be as reluctant to sign up to a treaty as they are to adopt the current guidelines. A broadly accepted international treaty would only be possible if the four issues were fully addressed.

This does not mean that uniform application of the same rules is an unachievable ideal. In the case of income taxes, near uniform application in respect of rules on cross-border transactions has been possible with the assistance of bilateral and multilateral agreements. The essential difference between VAT and income tax is the lack of a coordinating framework for VAT to reduce and resolve conflicts arising from variations in specific rules and interpretations and provide an effective dispute resolution mechanism for taxpayers. Thus, the critical issue for VAT may be not that the guidelines lack fixed standards and guidance, but rather that they are insufficient to establish a coordinating framework to deal with inconsistency in implementing national rules on destination basis taxation.

While addressing the issue might not necessarily involve creating a hard multilateral treaty from a broader international law perspective, the experiences in dealing with cross-border income tax issues and the impact of the VAT systems on government revenue and business operations do seem to point to a hard multilateral approach, which should be accompanied by a coordinating framework to resolve disputes.

2. *Pathways to a hard multilateral response*

The lack of an international VAT coordinating framework is largely a reflection of political economy: in the absence of any existing suitable mechanisms to resolve international issues in a coordinated fashion policymakers focus instead on domestic debates about VAT.

Broadly, there are three options for establishing an international coordinating framework with formal legal effect. The first is to incorporate rules and

26 (exchange of information) and 27 (assistance in the collection of taxes) indicate that those articles are not limited to covered taxes (ie taxes on income and capital) in art 2. The absence of such an express statement in art 25 could be taken to imply that its scope is limited to covered taxes. However, art 25(1) refers to 'taxation not in accordance with the provisions of this Convention', and thus 'taxes' are not limited to taxes on income and capital in the sense of art 2(2). See E Reimer and A Rust (eds), *Klaus Vogel on Double Taxation Conventions* (4th edn, Kluwer Law International 2015) 1786. Since the OECD and UN Models include arts 24, 26 and 27 which are not limited to covered taxes, the result would seem to follow that a taxpayer who considered that an action of a Contracting State breached art 24, for instance in relation to VAT that was not a covered tax, would be able to seek the MAP remedy under art 25.

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mechanisms implementing the destination principle into existing bilateral agreements or DTAs on income and capital. Many jurisdictions have entered into DTAs with their major trading partners to relieve double taxation for taxpayers and agree approaches to allocating tax revenues between contracting jurisdictions. A majority of the DTAs follow the OECD Model Tax Convention ('OECD Model').[123] The other major model, the United Nations Model Tax Convention ('UN Model'), is also largely based on the OECD Model, albeit with more consideration given to revenue interests of developing jurisdictions.[124]

The second option is a standalone bilateral agreement on VAT,[125] such as a Model Tax Convention on VAT ('VAT Model'), using the international guidelines as a basis to craft articles. OECD member countries could be required to apply the VAT Model to negotiate and conclude bilateral agreements on VAT with other jurisdictions. Non-OECD jurisdictions that are participants in the Global Forum on VAT might follow if an increasing number of jurisdictions started doing so.

The third option is to bypass the existing income tax treaty practice and adopt a multilateral treaty on VAT, which incorporates some OECD Guidelines and other related guidance but goes further in terms of legal effect and formality. A multilateral treaty would reduce the need for negotiation between individual jurisdictions, either for the inclusion of VAT rules into existing DTAs on income and capital or for a separate bilateral agreement on VAT. This would also mitigate the associated potentially high coordination costs.

The first two options, focusing on bilateralism, may not be optimal and feasible for several reasons from both substantive and procedural perspectives. First, they can complicate the already complex bilateral tax treaty systems, which have only become more complex with the introduction and implementation of new measures introduced to combat tax avoidance and evasion.[126] While the bilateral income tax treaty systems may have become more robust specifically to prevent tax avoidance and evasion, there may still be opportunities for abusive behaviours and the international move towards harmonised income tax rules still does not ensure alignment of tax outcomes for international dealings.[127] Second, the experiences with using either the OECD Model or the UN Model to negotiate, conclude and modify a vast number of actual DTAs have shown that it is a protracted process requiring significant effort for contracting jurisdictions to reach an agreement, which can be a particular concern for resource-constrained developing jurisdictions. Similarly, once an agreement is reached it can be difficult, or at

[123] OECD Model (n 22) arts 9–23. [124] UN Model (n 22) iii–xvi. [125] Ecker (n 15).

[126] J Brumby and M Keen, 'Tax Treaties: Boost or Bane for Development' (*World Bank Blogs*, 16 November 2016) <https://blogs.worldbank.org/governance/tax-treaties-boost-or-bane-development>; R Mason, 'The Transformation of International Tax' (2020) 114 AJIL 353.

[127] See eg V Arel-Bundock, 'The Unintended Consequences of Bilateralism: Treaty Shopping and International Tax Policy' (2017) 71 IntlOrg 349; J Davies, 'Tax Stability' (2020) 44 MULR 424.

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least time-consuming, to modify it.[128] Even if the two Models can be modified to include articles on VAT, or a separate VAT Model can be introduced, it is uncertain how long the process will take and whether the final outcomes can keep pace with the development of the digitalised economy. Third, it can be argued that existing mechanisms for mutual assistance under both DTAs on income and capital and multilateral agreements on tax administration are not restricted to income taxes, applying also to VAT and other taxes.[129] Such mechanisms include information exchange, assistance in tax collection, and the countering of tax avoidance and evasion. This suggests that relying on DTAs with inclusion of VAT rules or creating a standalone VAT Model for the application of the destination principle may be not necessary if the purpose is to utilise the mutual assistance mechanisms.

The first option of incorporating rules and mechanisms for the application of the destination principle into existing DTAs has been rejected in its totality in some studies.[130] Essentially, VAT does not fit within the existing DTA structure as it is a tax on final consumption and based on staged collection.[131] Income tax treaties fundamentally require persons entitled to benefits to be residents of one of the contracting States, and allocate tax revenue from a certain type of income or profit to a contracting State to avoid double taxation. However, since VAT is widely agreed to follow the destination principle and should always be imposed in one jurisdiction (namely, the jurisdiction of consumption, using the customer location as a proxy), income tax treaties cannot readily apply to VAT. As an indirect tax, VAT contrasts distinctly with income taxes whereby taxpayers bear the tax burden directly. This contrast renders it difficult to apply the principle of granting a personal benefit (as used with income taxes) to VAT taxpayers.[132] Existing bilateral income tax treaties are, thus, conceptually unfit to be extended or adapted to VAT.

There are a number of arguments against the second option of creating a standalone VAT Model.[133] On a substantive level, unlike DTAs that are mainly adopted to prevent double taxation through the allocation of tax revenues between residence and source jurisdictions, there is no dispute under VAT that the jurisdiction to tax is always the destination jurisdiction in a cross-border context. At least in theory, if the benchmark place of taxation

[128] P Harris and D Oliver, *International Commercial Tax* (CUP 2010) 18–20. The authors note that amending the two Models themselves is also a prolonged and difficult process.

[129] Actual DTAs based on the OECD or UN Model usually contain articles from 24 onwards that are applicable to other taxes for administrative cooperation. On a multilateral level, the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (as amended by Protocol in 2010) applies to all taxes including VAT. OECD Guidelines (n 8) 106–7; James and Ecker (n 39) 370–5.

[130] See Ecker (n 15) 79–84.

[131] For the features of VAT, see OECD Guidelines (n 8) 14–15.

[132] Ecker (n 15) 80–2; Millar, 'Looking Ahead: Potential Solutions and the Framework to Make Them Work' (n 119) 18.

[133] Millar, 'Looking Ahead: Potential Solutions and the Framework to Make Them Work' (n 119) 17–21.

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rules implementing the destination principle are interpreted and applied consistently, there should be no double taxation in both B2B and B2C transactions.[134] Moreover, businesses' concerns over double taxation in addition to a high income tax burden, especially in the early twentieth century when tax rates were generally high, was one of the main reasons for the emergence and development of bilateral tax treaties.[135] This concern does not arise with VAT as ultimately businesses are able to shift the tax costs to final consumers. The more concerning issues for VAT are, first, non-taxation which is inconsistent with the fundamental destination principle and amounts to a failure to apply the neutrality principle in VAT,[136] and second, the high compliance burdens imposed on businesses caused by the wide variety of different rules. Indeed, the differences in specific rules and their interpretation, rather than the conflict of determining jurisdiction to tax (as occurs under international income tax), are the most likely causes of double and non-taxation under VAT. There are also specific concerns with the creation of a VAT Model to consider. The experiences with bilateral agreements on income and capital illustrate that a bilateral VAT treaty network might create arbitrage opportunities for businesses, increasing the possibilities of non-taxation. Additionally, once established, variations to a VAT treaty could undermine the application of the destination principle.[137] The inherent drawbacks indicate why the idea of a separate VAT Model of a bilateral nature has not obtained international attention.

The recent significant growth of digital supplies, particularly during the global pandemic, has fuelled continuing effort and international discussion on ways to improve VAT enforcement, though this has been confined to the set of the international guidelines. The timing for considering a multilateral VAT convention is therefore propitious.

While VAT challenges and the inconsistency issue have been considered before, a multilateral response would have been unthinkable a decade ago.

[134] ibid 12.

[135] On the history of tax treaties, see S Jogarajan, *Double Taxation and the League of Nations* (CUP 2018); J Hattingh, 'On the Origins of Model Tax Conventions: Nineteenth-Century German Tax Treaties and Laws Concerned with the Avoidance of Double Tax' in J Tiley (ed), *Studies in the History of Tax Law*, vol 6 (Hart Publishing 2013) 31–79.

[136] Non-taxation occurs when an imported supply of services is not taxed, such as where there is a lack of effective collection mechanisms in the importing jurisdiction. Non-taxation also occurs when supply of services (eg healthcare) is exempt or when it is difficult to tax the supply on its value added (eg financial services). Non-taxation of B2B cross-border supplies is less significant than B2C supplies as VAT is not meant to tax intermediate businesses, except when the business makes supplies that are exempt from VAT without credits or is an entity not required for VAT, meaning the business needs to bear VAT. Millar (n 15) 7–21; Millar, 'Looking Ahead: Potential Solutions and the Framework to Make Them Work' (n 119) 7, 9. For the neutrality principle, see OECD Guidelines (n 8) Ch 2. In particular, there are two guidelines, Guidelines 2.4 and 2.5, applying to the neutrality principle in international trade. OECD Guidelines (n 8) 22–4. See also Millar (n 119) 19.

[137] Millar, 'Looking Ahead: Potential Solutions and the Framework to Make Them Work' (n 119) 18–19.

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However, the recent adoption of a multilateral income tax treaty, the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* ('MLI'), has created a precedent. The MLI was formally adopted in the BEPS project in 2016, with over 100 jurisdictions participating in the negotiations; and 99 jurisdictions signing it as of 16 September 2022.[138] Given the short timespan since its adoption and the magnitude of changes it brings to the over 3,000 existing DTAs, the achievement has been remarkable. Such achievement would have not been possible without a shared political will that base erosion and profit shifting is detrimental to the interest of most, if not all, jurisdictions. This means that a multilateral VAT convention may be attainable if there is sufficient political support and general understanding of the challenges global VAT systems face.

A bilateral model, whether incorporated in the income tax treaties or as a standalone treaty, has shortcomings related to the bilateral nature of such treaties that cannot be overcome. Therefore, a multilateral model is suggested which improves consistency in the implementation of the rules and mechanisms for applying the destination principle to cross-border trade in services and intangibles in the digitalised context. The merits of multilateral tax treaties are acknowledged as such treaties will 'generally promote legal certainty', offer 'uniform interpretation' (that is problematic in bilateral tax treaties), and permit efficient updates or revision, an 'advantage over coordination instruments of bilateral treaties'.[139] A multilateral treaty will also facilitate exchange of information and assistance in tax collection.[140]

A multilateral VAT treaty would no doubt draw on both existing practices and measures that are reflected in the OECD Guidelines. To be effective, however, a multilateral treaty must not only set out the common rules to be adopted by signatory jurisdictions, but also contain an effective enforcement and dispute resolution mechanism and agreed meanings for key terms and principles.

3. *Political economy feasibility of a multilateral treaty*

The multilateral treaty option could enable the consistent taxation of digital supplies on a destination basis. It is therefore notable that this option has not been seriously discussed at the international level. Indeed, the OECD, which took on a leadership role in coordinating and developing the MLI, has all but retreated to the form of guidelines only for VAT. Reaching a wide agreement on a multilateral VAT treaty depends on the political will of jurisdictions based on their national interests and needs.

[138] OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (adopted 24 November 2016, effective 1 July 2018) (MLI). See also OECD, 'Signatories and Parties to The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting' (2022) <https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>.

[139] Ecker (n 15) 66.

[140] ibid 67–8.

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An important factor behind the lack of serious consideration of a multilateral VAT treaty is the limited input to date of the OECD. That input has focused solely on soft law in the form of international VAT guidelines, notwithstanding the explicit recognition by its technical working party of the inconsistency problem attributable to the flexibility of soft guidelines. The limited OECD involvement is compounded by the UN's silence on VAT issues until very recently,[141] which is in contrast to its relatively active role in shaping the international rules and norms on income taxes.

Perhaps the relative lack of discussion is because the US, a driver of international tax policy and a dominant funder of the OECD, is the only member country that does not have VAT and therefore could be largely indifferent to the pressing concerns about the tax across the rest of the world.[142] In contrast, the EU, the home of VAT and a significant contributor to the development of international tax policy, has developed a Union-wide harmonised VAT system to address the problems of taxing digital supplies and allocating VAT revenue from cross-border trade within the Union. Since most commerce by European companies relates to cross-border trade within the Union, the EU may also be largely indifferent to the problems faced by jurisdictions outside the trading bloc.[143]

Despite limited OECD and UN involvement on a multilateral treaty to date, developing a multilateral VAT treaty would still be valuable to support international discussion on VAT as well as protection of revenue interests for individual jurisdictions. Harmonisation of global VAT systems for the application of the destination principle would not be an insurmountable task. This is because, while national VAT laws are designed in very different ways, they are 'remarkably similar' compared to income tax laws[144] and there is already wide agreement on the destination principle. As such, a consensus on the content of a multilateral treaty may not be too difficult to attain.[145] Support from the G20, which has a more balanced representation of developed and developing jurisdictions, will be crucial. In addition to its substantial work on VAT to date, the OECD has the Global Forum on VAT, a wide international community, to assist its ongoing work on VAT.

[141] UN Committee of Experts on International Cooperation in Tax Matters, 'Twenty-third Session: Virtual Meetings of 19 to 28 October 2021 Item 5 (n) of the Provisional Agenda Indirect Taxes (Other than Health Taxes)', E/C.18/2021/CRP.34, 4 October 2021. This document notes, on page 3 paragraph 3, that indirect taxes, particularly VAT, 'was for a long time not part of the Committee's workplans, partly due to the initial general Committee focus on tax treaties, and the limited resources to expand into areas of activities there were often not part of Member's areas of expertise'. The document also shows that the UN Tax Committee considered developing guidance on indirect tax issues especially for developing countries.

[142] While speculative it suggests why the world moved so quickly with the adoption of the MLI but not with a parallel VAT convention.

[143] This is also speculative, but may explain why there is a lack of leadership role from the EU.

[144] Ecker (n 15) 68.

[145] ibid.

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It could therefore act as the major operational body, with political backing of the G20, to develop the treaty. The UN should be encouraged to join the two organisations in developing the multilateral treaty to address global VAT challenges.

The convention may enlist necessary and imperative support from key members of the G20. The US, albeit with no VAT at the federal level, has state-level retail sales taxes. The US Supreme Court, in *South Dakota v Wayfair*, recognised that in the era of internet services, economic and virtual contact were a significant nexus in addition to the physical presence rule.[146] Many US states have since introduced or modified rules to ensure remote B2C transactions are taxed at the place of consumption. The US may be interested in having a uniform solution rather than unilateral actions across the states to mitigate compliance costs and facilitate trade.[147] Participation in a multilateral VAT convention could, indirectly, help the government, at both federal and state levels, achieve a uniform solution. It might even rekindle the country's interest in replacing the retail sales taxes with a federal VAT to boost its tax revenue,[148] though it could be politically difficult to do so.

The EU, as the most developed single trading bloc, has taken steps to develop its VAT law in both substantive and procedural aspects to meet challenges of the digitalised economy. Its experience in establishing harmonisation of the VAT system in general, and the application of the destination principle to digital supplies in particular, can provide a useful reference for the G20 and the OECD in designing a multilateral treaty.

As an important G20 member with a leading digital market, China may be eager to participate in the process of negotiating the multilateral treaty due to its primary reliance on VAT for revenue purposes.[149] Moreover, China would be an active participant given its recent shift of interest from being merely a rule-taker towards being a rule-shaker or even a rule-maker in international tax policy.[150] Importantly, as a developing economy, it can

[146] *South Dakota v Wayfair Inc*. (US) 138 S.Ct. 2080 (2018). See 'Recent Cases, Federalism: State v. Wayfair Inc.' (2018) 131 HarvLRev 2089; 'Leading Cases, Constitutional Law: South Dakota v. Wayfair, Inc.' (2018) 132 HarvLRev 277.

[147] At the US state level, specific sales thresholds apply to require remote sellers to collect and remit retail sales taxes which vary from state to state. Depending on the state, remote sellers may be required to collect tax on sales of services and digital goods in addition to physical goods. The variations may cause compliance burdens to both local and foreign businesses making inter-state and cross-border digital sales. KPMG (2021) (n 45) 149.

[148] See WJ Turnier, 'Designing an Efficient Value Added Tax' (1984) 39(4) TaxLRev 435, 435; Tax Analysts, *The VAT Reader: What a Federal Consumption Tax Would Mean for America* (Tax Analysts 2011).

[149] China's VAT contributes more than twice the revenue of the corporate income tax, which is the second most important tax in China. See Y Xu and R Krever, 'VAT Compliance Burdens in the OECD and China' [2021] BTR 328, 330.

[150] J Li, 'China and BEPS: From Norm-Taker to Norm-Shaker' (2015) 69(6/7) BFIT 355–70. The author notes in a more recent article that China's influence may be growing in respect of international tax governance, but the US continues to be the major power driving international

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contribute different perspectives and experiences that reflect developing jurisdictions' interests to the design of the treaty. The growth in international trade in services among developing jurisdictions underlines their importance in this process. An international coordination framework must attend to their interests to achieve the critical mass needed for the multilateral treaty approach to succeed.

Probably more importantly, a leader is needed to initiate a dialogue on the hard multilateral option and drive it to realisation. The vacancy of the leadership role could be filled by jurisdictions which support multilateral cooperation and have pioneered VAT policy related to cross-border digital supplies. For example, Australia has been among the first jurisdictions to introduce rules and measures to tax cross-border digital supplies on a destination basis. Some of the measures adopted, such as using online marketplaces to collect VAT in B2C transactions, have influenced the development of the international guidelines and VAT practices in other jurisdictions. During Australia's presidency of the G20, the government expressed a view that pressing issues can best be addressed by global governance initiatives.[151] Australia also showed support for a multilateral approach in international taxation through signing, ratifying and implementing the MLI.[152] Success of the multilateral convention will be dependent on the initiative shown by the jurisdiction leading the process. The leader must drive international tax policy on VAT, and promote consistent implementation of the destination principle to the benefit of both international trade and the interests of most jurisdictions.

This kind of leadership is crucial at the present time given the considerable impediments in international politics and the economy to multilateral initiatives ranging from trade to the environment. The geopolitical tensions and ongoing frictions between the EU, the US and China, crises within Europe, and the entrenched division of the developed and developing jurisdictions are examples of the obstacles to the multilateral approach to tackling common problems of the contemporary world.[153]

tax reform. While the US seems to have shown a US-centric multilateralism in the area of international tax, it is not clear how China's 'true multilateralism' will play out in global tax governance. The author also notes that China relies on international tax rules to generate revenue as VAT is the largest revenue source in the country. J Li, 'China's Rising (and the United States' Declining) Influence in Global Tax Governance? Some Observations' (2021) 75(11/12) BFIT 1–17. See also RC Christensen and M Hearson, 'The Rise of China and Contestation in Global Tax Governance' (2022) 28(2) Asia Pacific Business Review 165–86.

[151] M Parkinson and B Sterland, 'Innovations in Global Governance: Australia's G20 Presidency' (Australian Treasury 8 October 2014).

[152] OECD, 'Signatories and Parties to The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting' (n 138).

[153] As noted by think tank the Hinrich Foundation, the most recent remarks given by high-ranking US and EU officials imply that the era of globalisation is approaching an end as the leaders seem to intend to move to trade within a much more narrowly defined group of 'friends' who share common 'values'. See S Olson, 'Yellen, Lagarde, and the Death of the Global Trade

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In one sense, as the global VAT issue is part of a larger and highly contested conversation about what constitute fair conditions of global competition for digital products and services, it is difficult to identify how the impediments can easily be overcome. At the same time, however, there appears to be a wide consensus in respect of international taxation issues that multilateral responses are required to address tax challenges posed by the digitalised economy.[154] The BEPS project in the twenty-first century, with the current round of international tax reforms commonly labelled BEPS 2.0, signals a desire for a multilateral treaty response to the global tax issues by the international community. This is embodied by the Inclusive Framework consisting of 141 jurisdictions as at November 2021.[155] The potential benefits of a multilateral VAT treaty in terms of securing tax collection and preventing distortions to trade due to double taxation or unintended double non-taxation are obvious.

The introduction of a multilateral VAT treaty could not come at a better time for three reasons. First, VAT is the most important revenue source for many developing jurisdictions and developing jurisdictions constitute an important and growing part of the global digital economy. A hard multilateral treaty will provide more effective measures to protect the revenue interests of developing jurisdictions. Second, VAT is of growing importance for advanced economies as competition for global capital has led to reductions in corporate income tax rates and the share of corporate tax in total tax revenue falls, most often replaced by revenue from VAT. Increases in VAT rates have been common in the global economy.[156] A multilaterally coordinated framework on VAT systems would benefit advanced economies in seeking new revenue sources to fund their activities, especially in the post-pandemic recovery era. Third, the growing importance of digital supplies will only become more relevant and important in the post-pandemic world with further advances in technology and increased preferences for online shopping. There is an urgent need to reach uniform responses to protect revenue and preserve trade neutrality in the years to come.

V. CONCLUSION

The significant development of the digitalised economy has challenged the world's VAT systems in taxing cross-border digital supplies on a destination

System' Hinrich Foundation (4 May 2022) <https://www.hinrichfoundation.com/research/article/sustainable/yellen-lagarde-global-trade-system/?utm_medium=email&_hsmi=211981082&_hsenc=p2ANqtz-9M4eQXzL6qHItVeAW_Vs-S6h8GIQapeQLMuZOP7GhQxQzS6-j9Ui60RPBmvw1rsjosZ9W69xHPtn7sseb1oq58VOXq_w&utm_content=211981082&utm_source=hs_email>.

[154] Li (2021) (n 150) 15.

[155] OECD, 'Members of the OECD/G20 Inclusive Framework on BEPS' (November 2021) <https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>.

[156] An exception is Australia which has considerable political constraints on raising VAT rates or expanding VAT base.

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basis. The problem with international VAT systems is not a lack of technical rules but an absence of an international coordinating framework to tackle inconsistency in implementation. Neither unilateral actions nor a soft international response in the form of non-binding guidelines lead to the desired consistency. The preferred and necessary option is a hard international response in the form of a multilateral treaty. The ever-increasing importance of cross-border digital supplies and the urgent need for uniform responses to the global VAT challenges make this response imperative.

The world has over 3,000 bilateral income tax agreements based on different models with countless variations. It took almost a century for jurisdictions participating in the global economy to learn that the only way to vary all of them, simultaneously and equally, was with a multilateral treaty. There are no such pre-existing constraints on VAT and, this time, policymakers can commence with a better plan—a single, multilateral treaty on the most important indirect tax in the digitalised era. Digitalisation is a global phenomenon. A multilateral approach to digital taxation is needed for VAT as much as for income taxes.

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