Permanent Establishment issues in International VAT cases

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Why should the UN Tax Committee deal with VAT/GST issues?

- Mandate of the Committee is beyond income tax
- More than 150 countries have a VAT or GST legislation (including 21UN Tax Committee Member countries)
- Important revenue creator for tax administrations with less negative impact on growth than income taxes
- Ottawa Taxation Framework (1998), OECD International VAT/GST Guidelines (2011)
- OECD Global Forum on VAT on7-8 Nov 2012
- Some issues are not yet addressed:
  ->need for international consensus

VAT Basics

- Indirect tax on consumption
- Designed to burden only the final consumer
  - ->Any VAT incurred by a VAT registered Company can be refunded
- Destination Principle:
  Destination = place of consumption
  - Imports: Import VAT
  - Local supplies: VATable, VAT exempted
  - Exports: zero-rated

Terms to be used (not exhaustive)

- Valued-added Tax (VAT)
- Goods and Service Tax (GST)
- Output tax, Input tax
- Standard rate, reduced rate
- Zero-rated, or exempted turnover
- Reverse charge
- Recovery of VAT by nonestablished businesses
- Permanent establishment (PE)

First issue: Can a VAT registration of a non-resident seller trigger a PE for income tax purposes?

Facts:

Company A resident for income tax in country D sells goods to a third party company B in Country E for more than USD 1m. Company A is not resident in Country E for income tax purposes.

Export/Import: Assessment

Export from Country D by A and Import into Country E by B:

- Income tax:
  No PE for Company A in E

- VAT:
  Company A: zero-rated export from country D
  -> No VAT consequences in country E for A

  Company B: Import VAT to be paid and refunded as input tax in VAT return in Country B

Import into Warehouse of A in E with subsequent domestic sale

Facts:

Company A resident for income tax in country D sells goods to a third party company B in Country E for more than USD 1m. Company A is not resident in Country E for income tax purposes. Company A has a warehouse in country E, where he stores imported goods and have them delivered to Company B upon the sale.

Import / Domestic sale of goods: Assessment

Income taxes: No PE (article 5 para. 4 a) OECD MC; eventually PE (article 5 para. 4 a) UN MC)

VAT:
Import: A has to pay Import VAT in E, How can company A receives a refund of the respective input taxes?

Does A has to register for VAT purposes in E? Or

Can the Non-resident Company A register for VAT in E?

Subsequent domestic sale of goods from A to B:
Who has to declare the VAT on the VATable supply of goods?
- Either A as the non-resident seller or
- B as the resident recipient of purchase with the reverse charge mechanism in its VAT return of E

=>Does the potential VAT registration of A lead to a PE for income taxes in E?
=>Refund through VAT return or special Refund Procedure (13th EU Directive)

What is a «VAT PE», does it exist?

- Fixed place of business?
- Is it VAT registration?
- Are these vatable supplies in a country?
- Is it where the business is established or incorporated?
- Or a combination of some of the above?

- -> What will result in a business having a VAT PE?

Second issue: Does Transfer Pricing (TP) Adjustments have VAT consequences?

- Periodic TP adjustment by companies: Done through debit or credit note
  - -> creates indirect tax problems (VAT and customs duties)

- Same VAT treatment as original supplies (administrative burden to make the references to prior transactions)

- Some countries do not accept this, they say it is not a VATable supply and therefore no VAT can be charged nor recovered.

  -> leads to unrecoverable VAT burden

- Some countries request an adjustment of the tax base in the tax return and not by way of issuing a debit or a credit note

  ->VAT output or input taxes cannot be corrected

Recommendation:

We should establish a group dedicated to crossborder VAT implications, which studies different practices and makes recommendations for adoption of best practice.