

Thomas Ecker

A VAT/GST Model Convention

IBFD DOCTORAL SERIES

25

A VAT/GST Model Convention

Why this book?

Given the increasing problem of double taxation concerning value added tax (VAT)/ goods and services tax (GST) and the resulting constraints to international trade, it is time for the international community to take action. This book analyses the phenomenon of VAT/GST double taxation and possible remedies. VAT/GST treaties would be one of them.

But how should one design a VAT/GST treaty? To what extent do existing income tax treaties already apply to VAT/GST? Can income tax treaties simply be extended to VAT/GST or is there a need for a separate, independent VAT/GST treaty? Can the concepts, functioning, and structure of income tax treaties be used for VAT/GST purposes? What are possible alternatives? What should the scope of a VAT/GST treaty be? How can taxing rights be allocated between the parties to a treaty? These questions are answered in this book, based on an in-depth analysis of the basic principles underlying VATs/GSTs.

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Chapter 2

VAT/GST Double (Non-)Taxation

“Not all is sunshine in VATland, however. Clouds of varying sizes and shapes seem to be looming on the horizon in all VAT countries ...”

2.1. The rise of a problem

In the past, VAT/GST¹⁰ double taxation has not been perceived as a serious problem.¹¹ In recent years, however, this perception has changed substantially. The change of view is mainly triggered by two developments: the spread of VAT and the development and intensification of cross-border trade, especially in services. One can therefore agree with Eriksen and

9. Bird & Rotman, *Value-Added Taxes in Developing and Transitional Countries: Lessons and Questions*, paper prepared for the First Global International Tax Dialogue (ITD) Conference on VAT, p. 4 (15-16 March 2005).

10. For simplicity's sake, this book only refers hereafter to value added tax (VAT) when talking about general indirect taxes on consumption (expenditure). Thus, unless referring to a VAT of a specific state (e.g. an EU Member State) the term is also intended to cover similar taxes such as a goods and services tax (GST).

11. See e.g. OECD, Note by the Swiss Delegation on Double Taxation with Respect to Indirect Taxes p. 1 (22 September 1964), TFD/FC/174, where it is concluded that “[c]ases of effective double taxation, that is, the concurrent levying of indirect taxes on the same subject matter by two different States, seem comparatively rare.”; Ruppe, *General Report*, in *Cahiers de Droit Fiscal International*, Vol. LXVIIIb p. 109 (IFA ed., 1983), who did not see “major general problems” (p. 143) and concluded the harmonized assessment of the national reporters to be that “double taxation problems in the field of turnover tax are not considered particularly serious” (p. 146); see also OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles* para. 2 (June 2004); Avi-Yonah, *From Income to Consumption Tax: Some International Implications*, San Diego L. Rev., p. 1353 (1996); see, however, League of Nations Fiscal Committee, *Report to the Council on the Work of the First Session of the Committee* p. 6 (17-26 October 1929), C516.M.175.1929.II., published in *Legislative History of United States Tax Conventions*, prepared by the staff of the Joint Committee on Internal Revenue Taxation p. 4195 (p. 4200) (1962), where the International Chamber of Commerce is cited as having expressed the wish to extend the study of best means of avoiding double taxation to indirect taxes like, inter alia, turnover taxes; As main reasons for the lack of interest, Terra identifies the definition of double taxation, the possibility for input tax deduction for businesses and the fact that companies often treat(ed) VAT as a cost factor (see Terra, *The Place of Supply in European VAT* p. 2 (1998), with further references).

Hulsebos: as the world is getting smaller, the VAT implications are getting bigger.¹²

Consumption taxes, such as value added taxes (VAT), goods and services taxes (GST), or retail sales taxes, have been around for about 60 years and, thus, are fairly young compared to direct taxes. The first theoretical design of a VAT was published by Wilhelm von Siemens, a German economist, in 1919¹³ and almost parallel by an American economist, Thomas S. Adams.¹⁴ The first modern VAT¹⁵ was introduced in France in 1954,¹⁶ masterminded by Maurice Lauré.¹⁷ Despite its relatively young age, VAT has been spreading around the globe with enormous speed since its first introduction. In the words of Bird and Rotman: “Over the last few decades, VAT has swept the world.”¹⁸ Today, over 150 countries have implemented a VAT of some sort.¹⁹ Over 100 of those countries have introduced VAT within the past 20 years.²⁰ In future, the number of countries relying on VAT is expected to further increase. Additionally, there has been a clearly identifiable trend towards a shift to VAT and indirect taxes for the financing of states’ budgets in the past years.²¹ This trend is also in accordance with the policy recommendations

12. See the subtitle of Eriksen & Hulsebos, *Electronic Commerce and VAT – An Odyssey towards 2001*, VAT Monitor, p. 137 (2000).

13. See Von Siemens, *Veredelte Umsatzsteuer* (1919), and 2nd (extended) ed. (1921).

14. Adams first wrote on the subject in 1915, though he is commonly cited for his article published in 1921, Adams, *Fundamental Problems of Federal Income Taxation*, Q. J. Econ., p. 527 (1921) (see Krever, *Designing and Drafting VAT Laws for Africa*, in *VAT in Africa* p. 15 (Krever ed., 2008); Rendahl, *Cross-Border Consumption Taxation of Digital Supplies* p. 4, n. 4 (2009).

15. Being a non-cumulative VAT based on the credit invoice method.

16. *Loi n° 54-404 du 10 avril 1954 portant réforme fiscale*, *Journal Officiel* de la République Française, p. 3482 (11 Apr. 1954); this was the first VAT introduced by a sovereign state. Earlier, the US state of Michigan had already adopted a VAT-like tax (see Krever, *VAT in Africa*, p. 15).

17. See Lauré, *La taxe sur la valeur ajoutée* (1953); at the time, Lauré was joint director of the *Direction générale des impôts*, the French tax authority.

18. Bird & Rotman, p. 3; Bird therefore also considers it “unquestionably the most successful fiscal innovation of the last half-century” (see *Commentary* by Bird to Crawford, Keen & Smith, *Value Added Taxes and Excises*, in *Dimensions of Tax Design: The Mirrlees Review* p. 363 (Mirrlees et al. eds., 2010)).

19. See OECD, *Consumption Tax Trends 2010* pp. 37 and 50 and Annex B (2011); see also Bird & Gendron, *The VAT in Developing and Transitional Countries* p. 16 (2007); OECD, *Consumption Tax Trends 2008* p. 32 (2008); with the exception of the United States, all OECD Member countries have implemented a VAT; on the spread of VAT, see Gillis, Shoup & Sicat, *Lessons for Developing Countries*, in *Value Added Taxation in Developing Countries* p. 229 (Gillis, Shoup & Sicat eds., 1990).

20. ITD, *The Value Added Tax: Experiences and Issues* p. 9, background paper prepared for the ITD Conference on the VAT (Rome, 15-16 March 2005).

21. See e.g. Lejeune, *Designing VAT/GST Law to Be Effective and Efficient: A Global Benchmarking of VAT/GST Systems*, in *The Future of Indirect Taxation: Re-*

of the OECD, which suggest revenue-neutral tax reforms that “shift the burden of taxation from income to consumption and/or residential property.”²² And with an increased need for the financing of states’ budgets, especially in times of a financial crisis, this trend can be expected to continue.²³

Simultaneously, globalization, deregulation and rapid improvements in technology have led to a drastic increase in global trade and international cross-border activities.²⁴ And this development not only concerns trade in goods but also increasingly trade in services.²⁵ Multinational businesses will often seek to concentrate certain group functions in a particular state to benefit from economies of scale or supply chain efficiencies. They may take benefit of shared service centres, centralized sales and procurement functions, call centres, data processing and information technology support, and the like. As a result, the share of services and intangibles in international trade is significant and growing rapidly.²⁶ Furthermore, services may take new forms and telecommunication services and electronically supplied services particularly are increasingly supplied across borders. Technological advances have led to new forms of services (e.g. many Internet-based services such as grid computing services,²⁷ events on

cent Trends in VAT and GST Systems Around the World – A Global Comparison pp. 723 et seq. (Ecker, Lang & Lejeune eds., 2012). Over the past 23 years, the share of VAT as a percentage of total tax revenue has grown by more than 65%, passing from 11.2% on average in 1985 to 18.7% in 2008 (OECD, *Consumption Tax Trends 2010*, p. 50; see also OECD, *Revenue Statistics 1965-2008* (2009) p. 91, Table 29; Charlet & Owens, *An International Perspective on VAT*, Tax Notes Int’l, p. 943 (2010); between 2000 and 2006, this percentage had increased by an average of 0.6 among OECD Member countries (OECD, *Consumption Tax Trends 2008*, p. 42, Table 3.2).

22. See OECD, *Tax policy reform and economic growth* (2010) p. 21. The main reason for this policy suggestion is that according to the study mentioned, corporate and personal income taxes are more harmful for economic growth than e.g. consumption taxes or recurrent taxes on immovable property.

23. See also the findings of a survey conducted by KPMG (KPMG, *Indirect Taxation and Business – a Global Perspective, A survey of attitudes to indirect taxes in 520 companies across 22 countries – July 2008*).

24. The average worldwide real trade growth between 1974 and 2007, for instance, was 5% per year (WTO, *World Trade Report 2008 – Trade in a Globalizing World* (2008) p. 15).

25. See also Grandcolas, *VAT on the Cross-Border Trade in Services and Intangibles*, Asia-Pac. Tax Bull., p. 39 (2007); Crawford, Keen & Smith, *Value Added Taxes and Excises*, p. 342.

26. See e.g. WTO, *World Trade Report 2008 – Trade in a Globalizing World*, p. XX; OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, para. 1 (2004).

27. See e.g. Parrilli, *Tax Treatment of Companies Providing Grid Services: Direct v. Indirect Taxation*, in *Value Added Tax and Direct Taxation – Similarities and Differences* p. 743 (Lang et al. eds. & Ecker ass. ed., 2009).

platforms like “Second Life”, or voice over the internet (VOIP), just to randomly name three out of an almost infinite number of examples) that may sometimes be difficult to characterize and therefore bear the risk of being subject to different treatment by different states. While historically cross-border trade mainly concerned goods and services that were primarily traded in domestic markets, today the situation has changed.

The two developments – the spread of VAT and the increase in cross-border economic activities – together have led to a new situation where global actors generally have to deal with two or more different VAT jurisdictions when carrying on international business. In some of these cases, as a consequence of the absence of internationally agreed principles, more than one country may want to levy tax on a cross-border transaction. The result is double or multiple taxation (or in the inverse case, double or multiple non-taxation).²⁸ For simplicity’s sake, this book will only refer to double taxation. It should always be considered, however, that the risk of double taxation may also imply a risk of multiple taxation.

Conceptually, VAT double taxation and unintended VAT non-taxation should not exist, not even in cross-border cases. If it nevertheless occurs, it conflicts with fundamental principles of the tax. VAT double (non-taxation) should not exist because VAT is a tax on final consumption (expenditure)²⁹ and therefore should be levied only in the state where a supply is (most likely) consumed.³⁰ In practice, however, states may have different perceptions of where a supply is most likely consumed. If they concur on the place of consumption, they may still apply diverging place of taxation rules for efficiency, simplicity, practicality or other considerations.³¹ Finally, as discussed below, VAT double (non-)taxation may even occur where states have common or coordinated rules.³² If it does occur, VAT double (non-)taxation is in conflict with the basic conceptual principles of VAT, especially the principle of neutrality. Double (non-)taxation may result in simi-

28. For some examples, see Millar, *Cross-Border Services: A Survey of the Issues*, NZ J Tax L & Policy, p. 302 et seq. (2007); OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, p. 8 et seq. (2004); see generally Ruppe, *General Report*, p. 121 et seq.

29. I put this term in brackets as, formally, expenditure is taxed but, substantively, expenditure is rather an indicator of what the tax actually intends to tax, i.e. either consumption or ability to pay (see section 8.1).

30. Id.

31. See section 8.6.

32. See sections 3.3. and 3.6.

lar goods or services bearing a different tax burden. The consequence may be distortion of competition.³³

Economically, VAT double taxation is not desirable either. While there is no interdiction of double taxation in general international law,³⁴ the OECD Commentary considers that:

[The] harmful effects of double taxation (such as distortion of competition) on the exchange of goods and services and movements of capital, technology and persons are so well known [that they consider it] scarcely necessary to stress the importance of removing the obstacle that double taxation presents to the development of economic relations between countries.³⁵

Early works of the League of Nations even refer to the “evil effects of double taxation”³⁶ and consider it “unjust and uneconomic.”³⁷ While the effects of income tax double taxation are not completely identical to those of VAT double taxation, the OECD’s conclusion is certainly also valid for VAT.

For a state that wishes to foster exports of goods or services, VAT double taxation is likely to conflict with trade policy.³⁸ VAT double taxation may

33. For a detailed discussion of the principle of neutrality, *see* section 8.2.; non-taxation, however, should generally only lead to distortions of competition where the customer is not entitled to (full) input VAT recovery (*see also* Millar, *Intentional and Unintentional Double Non-Taxation*, in *Value Added Tax and Direct Taxation – Similarities and Differences* p. 418). If full recovery is possible, VAT should not be a cost for the customer in any case (unless perhaps if the recovery procedure is costly and burdensome).

34. *See e.g.* German Federal Fiscal Court (*Bundesfinanzhof*), 14 Feb. 1975, VI R 210/72, BStBl. II 1975, p. 497; Vogel, *Einl.*, in *DBA MN 14* (Vogel & Lehner eds., 5th ed., 2008); Kemmeren, *Principle of Origin in Tax Conventions* p. 17 (2001); Fischer, Kleineidam & Warneke, *Internationale Betriebswirtschaftliche Steuerlehre* 5 p. 32 (2005); Mössner, *Steuerhoheit und deren Anknüpfungskriterien*, in *Steuerrecht international tätiger Unternehmen MN B2* (Mössner et al. eds., 3rd ed., 2005); Wassermeyer, *Vor Art. 1*, in *Doppelbesteuerung*, MN 1 (Debatin & Wassermeyer eds., 103rd supplement (2008)); Schaumburg, *Internationales Steuerrecht*, 3rd ed., MN 14.3, with further references (2011).

35. *See* OECD Model, Introduction, para. 1.

36. League of Nations, *Double Taxation and Tax Evasion*, Reports and Resolutions submitted by the Technical Experts to the Fiscal Committee of the League of Nations (7 Feb. 1925).

37. *See* League of Nations, *Report on Double Taxation: Document E.F.S.73. F.19*, League of Nations Economic and Financial Commission, p. 9 (Profs. Bruins, Einaudi, Seligman & Sir Josiah Stamp, 5 Apr. 1923), published in *Legislative History of United States Tax Conventions* p. 4013, prepared by the staff of the Joint Committee on Internal Revenue Taxation 1962).

38. Bächle, for instance, concludes that it is certainly in the national interest of states to relieve their tax-nationals from tax if they undertake economically desirable ac-

burden or even be a barrier for cross-border trade. Double imposition of VAT, especially if irrecoverable, adds a cost element to the exported supplies.³⁹ If this cost leads to a price increase for the supply, demand for the supplies in the importing state may decline (e.g. due to substitution effects). This would reduce the supplier's profits and thus be a burden on him. And where consumers are dissuaded from consumption through the rise of the price of an imported commodity or service due to the tax, VAT double taxation can even function as a trade barrier.⁴⁰ Similarly, if, due to VAT double taxation, the demand in the importing state declines to an extent that does not render the cross-border supply profitable (anymore), double taxation will usually become a barrier for the supply. If the exporter could prevent a price increase by entirely compensating – and thus bearing – the tax, his profits would decline and again he would be burdened. A decline of profits from the export to below nil will generally prevent the supplier from exporting and thus, again, VAT double taxation would function as a barrier.⁴¹ These two extreme scenarios (the supplier or the consumers fully bearing the tax) illustrate the general dilemma. Irrespective of to what extent double imposition of VAT is reflected in the price of the exported goods, the exporter's profit will decline. Demand would decrease and/or the supplier's cost would increase. In any case, the supplier would bear a burden. As a limit, the cross-border supply would no longer be profitable, and double taxation would function as a trade barrier as it would dissuade the supplier from exporting. If double imposition of VAT only occurs in cross-border situations, the exporter will generally have a competitive disadvantage over domestic suppliers. As the OECD International VAT/GST Guidelines note, VAT double taxation may favour domestic trade over imports or may discourage outsourcing.⁴²

tivities in another state (*see* Bächle et al., *Internationales Steuerrecht*, 2nd ed., p. 17 (2008); *see also* Jacobs, *Internationale Unternehmensbesteuerung*, 6th ed., p. 5 (2007).

39. But even if recoverable, the recovery procedure in itself may cause costs.

40. *See more generally*, as the experts Bruins, Einaudi, Seligman and Stamp already concluded in their League of Nations work, p. 8, printed at p. 4012, which underlines that “the burden and the barrier, in the case of double taxation, are striking instances of this general doctrine.”

41. In this regard, VAT double taxation may lead to a higher break-even price and thus impede the supplier from exporting a good or service (*see also* Kahler, *Die Freistellungsmethode in deutschen Doppelbesteuerungsabkommen und ihre Vereinbarkeit mit dem EG-Vertrag* p. 23 (2007); Kluge, *Das Internationale Steuerrecht*, 4th ed., B MN 32 (2000)).

42. *See* OECD, *International VAT/GST Guidelines* (OECD VAT/GST Guidelines), Preface, para. 7 (February 2006); in a similar direction with respect to income tax double taxation, *see* Schaumburg, *Internationales Steuerrecht*, MN 14.13; Lornsen, *Unilaterale Maßnahmen der Bundesrepublik Deutschland zur Ausschaltung der Doppelbesteuerung bei der Einkommen- und Körperschaftsteuer* p. 35 et seq. (1987).

Double taxation is generally also undesirable from the point of view of the importing country if a state does not intend to discourage imports. Unrecoverable⁴³ VAT double taxation will generally have negative economic effects because it will usually lead to increased prices for the imported goods and services, as well as for the (domestic) goods and services that will be used as a substitution.⁴⁴ This again may lead to higher inflation⁴⁵ and – at least in the short term – can reduce the consumers' purchasing power. As the four economists held in 1923 in their fundamental work on double taxation:

[I]t is a truism of public finance that a tax on consumption is not only a burden on those who consume but a barrier to those who now no longer consume because they are dissuaded from consumption through the rise of the price of the commodity in question due to the tax.⁴⁶

This is also applicable to considerations of non-recoverable VAT double taxation as it increases this burden.

Finally, welfare considerations as well are generally a reason to advocate the prevention of non-recoverable VAT double taxation. Overall, cross-border trade usually brings welfare benefits. Through international trade, states may benefit from the international diversity of resources⁴⁷ and a greater variety of products and services offered to consumers. Through international trade, states may furthermore benefit from differences in pro-

43. It should be noted that prevention of VAT double taxation automatically prevents unrecoverable VAT double taxation.

44. See McLure, *Income Distribution and Tax Incidence under the VAT*, in *Value Added Taxation in Developing Countries* p. 33 (Gillis, Shoup & Sicut eds. 1990), using the example of a protective import trade tariff. In substance, however, these considerations should be transferable to non-recoverable VAT double taxation as both add a cost element to the imported supply.

45. Most likely as a one-time effect (see Gillis, Shoup & Sicut, p. 221).

46. League of Nations, *Report on Double Taxation: Document E.F.S.73. F.19*, *League of Nations Economic and Financial Commission*, p. 8 (5 Apr. 1923), published in *Legislative History of United States Tax Conventions*, p. 4012.

47. Samuelson and Nordhaus paint an incisive picture of some consequence of the absence of cross-border trade: "Canadians could drink no wine, Americans could eat no bananas and most of the world would be without Jazz and Hollywood movies." (Samuelson & Nordhaus, *Economics* p. 297 (2001)).

duction costs and, according to Ricardo's theory,⁴⁸ they may benefit from comparative advantages.⁴⁹ In the words of Musgrave:

International efficiency requires that tax systems of trading nations not interfere with the free flow of trade and capital so that resources are universally allocated where they will be the most productive, carry the highest rates of return and thereby maximize world welfare.⁵⁰

If VAT double taxation risks being a restraint for international trade it must be assessed critically from a global welfare point of view and therefore should be prevented.⁵¹

It seems clear that VAT double taxation is not desirable. But is the problem significant enough to require counter measures? A study conducted by the OECD in 2004, carried out with continued input from business, academics and selected non-OECD economies, says yes. Although the significance of the problem of VAT double taxation is hard to measure in precise terms,⁵² the OECD's analysis showed a trend and pattern implying that the problem is sufficiently significant to require action at an OECD level. OECD Member countries thus have recognized that – at least in the area of services and intangibles – the absence of internationally agreed approaches today leads to difficulties significant enough that their impact on both businesses and governments calls for remedies.⁵³

48. See Ricardo, *On the Principles of Political Economy and Taxation* (1817); put very generally, the theory of comparative advantage holds that all states will benefit if they specialize in the production and export of those goods and services that they can produce at a relatively low cost.

49. For the benefits of international trade, see e.g. Samuelson & Nordhaus, p. 297 et seq.; Cnossen, *Interjurisdictional Coordination of Sales Taxes*, in *Value Added Taxation in Developing Countries*, p. 47.

50. Musgrave, *International Aspects of Value Added Taxes: Lessons for Developing Countries*, VAT Monitor, p. 111 (2001).

51. Some even consider the prevention of double taxation to be an "imperative of economic rationality" (*Gebot wirtschaftlicher Vernunft* (author's translation); see Schaumburg, *Internationales Steuerrecht*, MN 14.15; Nieland, *Doppelbesteuerungsabkommen als Problem innerstaatlicher Rechtsetzung* p. 47 (1989); Lornsen, p. 34 et seq.; see also Escher, *Die Methoden zur Ausschaltung der Doppelbesteuerung* p. 63 (1974); Tipke, *Steuergerechtigkeit in Theorie und Praxis* p. 120 (1981), who both speak of "a rule of intelligence" (*Klugheitsregel* – author's translation); all with respect to income tax double taxation).

52. E.g. by measurement in terms of tax cost, compliance costs or revenue losses related to the inability to enter markets or achieve business efficiencies.

53. See OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, especially para. 40 (2004); similarly, in a public consultation the respondents pointed out that even within the EU, VAT double taxation is an existing and difficult problem (see European Commission, *Report on the Outcome of the*

2.2. Defining double taxation

Before elaborating further on the reasons for double taxation, one should first define what is meant by double taxation. There is less common understanding of double taxation for VAT than for income taxes, for example.⁵⁴ “Double taxation” is not a *terminus technicus* and different types of double taxation can be distinguished.⁵⁵

VAT double taxation as used in this book covers situations *where two states levy VAT on the same supply*.⁵⁶ Consequently, tax cascading is not covered by this definition.⁵⁷ Admittedly, tax cascading also leads to double taxation from an economic point of view. If VAT is levied at multiple stages and is not recoverable, the tax base for the supply to the final consumer will include tax on tax. Still, this book takes a more formal approach as the reason for tax cascading is usually a conscious one by a single state and as a rule not due to overlapping jurisdiction to tax.

On the other hand, double taxation as defined in this book will generally also cover cross-border transactions where the double imposition of tax does not necessarily mean that, economically, the final consumer will actually have to bear more than the tax levied by only one state. If, for instance, double taxation arises in a business-to-business (B2B)⁵⁸ scenario, the re-

Consultation on “Introduction of a Mechanism for Eliminating Double Imposition of VAT in Individual Cases”, 24 Oct. 2007, TAXUD/D1/EWS/mav D (2007) 15925, p. 2.
54. See also Eriksen & Haydl, *Avoidance of VAT/GST Double (Non-)Taxation: Recommendations and Other Types of Soft Law v. Legally Binding Instruments to Allocate Taxing Rights Between States* (e.g. *Bilateral Tax Treaties*), *Value Added Tax and Direct Taxation – Similarities and Differences* p. 1151 (Lang et al. eds. & Ecker ass. ed., 2009).

55. E.g. double taxation in a narrow vs a broad sense; formal vs substantial; typical vs atypical; technical vs non-technical; legal vs juridical vs economic; direct vs indirect; and horizontal vs vertical double taxation (see Wassermeyer, *Vor Art. 1*, MN 1, with further references).

56. “Supply” in this respect should be understood as also covering cross-border movement of goods (i.e. exports and imports) if they are taxable; for a similar definition of double taxation, see also Ruppe, *General Report*, p. 114; Terra, *The Place of Supply in European VAT*, p. 2; Rendahl, pp. 7 and 23; Stadie, *Einf.*, in *Umsatzsteuergesetz* MN 277 (Rau & Dürrwächter eds., 129th supplement (2007)); see Terra & Kajus, *A Guide to the Recast VAT Directive*, IBFD Online Commentary to the EC VAT Directive Chap. 5.1.2 (last reviewed 1 Sept. 2010).

57. This definition follows a constitutive approach rather than a goal-oriented or result-oriented approach. (for an overview of the different approach, see Grotherr, *Doppelbesteuerung*, in *DBA-Kommentar* 22 Teil 1 Abschnitt 1 MN 9 et seq. (Becker et al. eds., 12th supplement 2003).

58. A “business-to-business supply” is a supply where both the supplier and the customer are businesses.

ceiving business should in theory usually be able to fully recover VAT. In such a case, formal double taxation should not lead to a higher tax burden for the final consumer, as it need not be passed on.

These considerations raise a valid question: Why should a VAT treaty cover B2B transactions? First of all, not all businesses can (fully) recover input VAT. In most states, for instance, input VAT of a supply cannot be recovered if it is connected with an exempt output supply.⁵⁹ Second, even if a business is theoretically entitled to refunds, it may often encounter problems obtaining such a refund in cross-border situations. According to a recent OECD survey, 80% of businesses cannot fully recover their foreign VAT.⁶⁰ Third, even if businesses can fully recover input VAT, there may be compliance costs involved with the additional need for (in many cases cross-border) input VAT recovery. The proposed VAT treaty – especially if employed together with a reverse charge mechanism – can significantly reduce the necessity for cross-border refunds and thus alleviate these problems.

The definitions for double taxation used by the OECD Commentary for income tax treaties are not useful for VAT purposes. The OECD Commentary distinguishes between *juridical* and *economic* double taxation. The Commentary defines *juridical* double taxation as “the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods.”⁶¹ For VAT purposes, this definition would be too narrow. From a technical design perspective, VAT is a transaction tax. The object of taxation is the supply.⁶² Consequently, it is the supply that should not be taxed twice rather than a taxpayer.⁶³ If two states levy VAT on a certain supply in the hands of different taxpayers (e.g. because one state applies a reverse charge but the other does not) this is not a desirable result, although it would not be a case of juridical double taxation. *Economic* double taxation is defined by the OECD Commentary as

59. For more details, see section 17.4.1. This also concerns non-taxable customers registered for VAT because they are considered to be businesses for allocation rule purposes in the VAT treaty conceptualized in this book. Since they provide non-taxable supplies, they cannot recover VAT.

60. See e.g. Buydens & Charlet, *VAT and GST Refunds*, The Tax Journal, p. 21 et seq. (2009.); OECD, *Consumption Tax Trends 2008*, pp. 35-36; OECD, *VAT/GST Relief for Foreign Businesses: The State of Play, A Business and Government Survey* (Feb. 2010).

61. *OECD Model Tax Convention on Income and on Capital: Commentary*, Introduction para. 1; see also para. 1 *OECD Model: Commentary on Article 23A and 23B*.

62. For more details, see section 8.4.

63. In this sense, see also Ruppe, *General Report*, p. 114.

“taxation of the same income in the hands of different persons”.⁶⁴ Whether or not such a definition can be useful for VAT purposes depends on how it is adapted for VAT purposes. If, for instance, a good is passed on through a chain of businesses to finally be acquired by a consumer, the goodwill will be taxable in the hands of many different persons, even if every transaction is taxed only once and VAT is recoverable throughout the business chain. This type of multiple taxation of course is to the result of the very technique by which VAT is levied and hence is not problematic. The more appropriate approach is therefore to translate the OECD Commentary definition by using the term “supply” instead of the term “income”. As a result, economic double taxation would be the levying of VAT on the same supply in the hands of different persons. Understood in this sense, economic VAT double taxation is not desirable and should therefore also be prevented.

The concept of double taxation underlying this book (i.e. where two states levy VAT on the same supply), encompasses both juridical and economic double taxation.⁶⁵ It concerns the *imposition of tax on the same supply by two different states, irrespective of whether the tax is levied from the same or different taxpayers*. While a clear understanding of the notion “double taxation” is necessary for conceptualizing a VAT treaty, it is not relevant for its application.⁶⁶

2.3. Causes of double (non-)taxation

*“Don’t tax you, don’t tax me, tax that fellow behind the tree.”*⁶⁷

The causes of VAT double (non-)taxation⁶⁸ differ quite significantly from the causes of income tax double taxation, for example. With *income tax*,

64. Para. 5 *OECD Model: Commentary on Article 9*; see also para. 40 *OECD Model: Commentary on Article 10*; para. 1 *OECD Model: Commentary on Article 11*; para. 2 *OECD Model: Commentary on Article 23A and 23B*.

65. In contrast, the OECD Model primarily aims to prevent only juridical double taxation (see e.g. *OECD Model: Commentary*, Introduction para. 3 or paras. 1 and 2 *OECD Model: Commentary on Article 23A and 23B*; with exceptions like article 9 of the OECD Model, which is intended to prevent economic double taxation).

66. For income tax treaties, see Vogel, *Einl.*, MN 5.

67. J.L. Yablon, *As Certain as Death – Quotations About Taxes*, Tax Notes Today, p. 225 (1994), available in LEXIS, Taxana Library, TNT File (statement of Senator Russel B. Long (D. La.)), cited in Avi-Yonah, *From Income to Consumption Tax*, p. 1329, n. 2.

68. This section only examines “non-taxation” in the sense of *unintended non-taxation*. The issues of double taxation and non-taxation are not completely symmetrical as states sometimes intentionally refrain from taxing a supply (e.g. through exemptions).

states use different rationales for taxing the same income: *residence* and *source*. Hence, more than one state may have a rationale to tax. The problem of double taxation is thus inherent in the system of income taxation. Most states tax a person's worldwide income if that person is a resident of that state. At the same time, most states also tax income that they consider sufficiently linked to their jurisdiction (at source), even if the taxpayer is not resident in that state. Consequently, even if states were to apply the same domestic rules and even if there was no diverging characterization based on interpretation of law or of facts, double taxation would still regularly occur with respect to income taxes.

Income double taxation can arise in three basic scenarios.⁶⁹ If a person is resident in more than one state, then these states are likely to all tax the person's worldwide income. Hence, double taxation would be the result of *dual residence*. Furthermore, it may arise if a person is a resident of one state but the income is economically linked to another state. In such a case, the residence state will likely tax the person's worldwide income while additionally the other state will tax the income linked to it. Hence, double taxation is due to the result of tax claims based on *source vs residence*. This is the most prevalent cause of income tax double taxation.⁷⁰ Finally, two states may consider income sufficiently linked to them, even if the taxpayer is resident in neither state (*source vs source*).⁷¹ This type of double taxation is special in so far as it could theoretically be eliminated if states agreed on when income should be considered sufficiently linked to a state to justify taxation.⁷² Income tax treaties following the OECD or UN Models generally only aim at preventing the first two types of double taxation.⁷³

Furthermore, one should not forget that non-taxation is much less an issue where business can fully recover input tax. See OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, p. 30; for a broader discussion of intentional and unintentional non-taxation, see Millar, *Intentional and Unintentional Double Non-Taxation*, in *Value Added Tax and Direct Taxation – Similarities and Differences* (Lang et al. eds. & Ecker ass. ed., IBFD 2009), p. 409 et seq., who also provides a number of examples for unintentional non-taxation (p. 428 et seq.).

69. See para. 3 et seq. *OECD Model: Commentary on Article 23A and 23B*.

70. See e.g. Schaumburg, *Internationales Steuerrecht*, MNs 13.3 and 14.1.

71. For a similar classification in source vs source, residence vs residence and source vs residence, see also Holmes, *International Tax Policy and Double Tax Treaties* pp. 23-24 (2007); Schaumburg, id., at MNs 13.3, 13.5 and 14.1; Lang, M., *Introduction to the Law of Double Taxation Conventions* MN 4 et seq. (2010); Panayi, *Double Taxation, Tax Treaties, Treaty Shopping and the European Community* pp. 14-15 (2007).

72. In this direction, see also Schaumburg, id., at MN 13.4.

73. See para. 11 *OECD Model: Commentary on Article 23A and 23B*; see also Aviyonah, *From Income to Consumption Tax*, supra n. 11, at 1330.

In contrast, the rationale underlying a *consumption tax* like VAT is to tax consumption (expenditure).⁷⁴ The imposition of VAT by a state is justified if one can assume a supply to be consumed in that state. As a consequence, VAT double taxation may only arise if more than one state assumes a supply to be consumed in its territory. In contrast to income taxes, states generally do not tax persons on their worldwide consumption of supplies based on their residence.⁷⁵ Other than with income taxes, VAT double taxation is therefore not a system-inherent phenomenon.⁷⁶ In VAT, double taxation based on dual residence⁷⁷ or based on place of consumption vs residence⁷⁸ should not be an issue conceptually. If one wants to compare causes of VAT double taxation with the situation for income taxes, it seems most appropriate to compare it with the case where two states tax because – according to the principle of territoriality – they consider income sufficiently connected to their jurisdiction (*source vs source*). VAT regimes also follow the territoriality principle and the relevant connecting criterion is consumption. It may therefore be that more than one state levies tax because they all consider a certain supply to be consumed in their jurisdiction (*consumption vs consumption*).⁷⁹

Interestingly, the source vs source type of double taxation is generally not subject to income tax treaties following the OECD or UN Model as they

74. For details and references, see section 8.1.

75. While generally justified, to my knowledge, no state currently uses such taxes (like a personal expenditure tax). Some jurisdictions use a legislative technique starting with a global reach, but they usually extensively zero-rate transactions not connected to their territory and thus are in effect very similar to destination-based VAT/GST systems following the territoriality principle; see section 10.1. for more details and references.

76. See also Cooper & Vann, *Implementing the Goods and Services Tax*, Sydney L. Rev., p. 419, n. 257 (1999); Bizioli, *Comparative Analysis of the Causes of Double (Non-)Taxation in the Income and VAT/GST Contexts*, in *Value Added Tax and Direct Taxation – Similarities and Differences* p. 396 (Lang et al. eds. & Ecker ass. ed., 2009).

77. Dual residence may be an issue, however, where residence of a person is used as proxy for consumption (see section 16.2.11.). But even in such a case, double taxation is not a result of two states taxing a person on worldwide consumption but rather two states considering that a certain supply is consumed within their jurisdiction, the residence of the person being an indicator of where consumption most probably takes place. Thus, there is a conceptual difference from double taxation based on dual residence in income taxation.

78. Of course, residence can be a proxy for the place of consumption. Nevertheless, in such a case a state still taxes because it considers a supply consumed in its territory rather than because it submits a resident person to worldwide taxation. Conceptually, there is thus again a difference from income taxation.

79. For the OECD's efforts to draft International VAT/GST Guidelines, see section 3.3.

require the taxpayer to be a resident of a contracting state.⁸⁰ The problem is mostly solved, though, if the source states have concluded tax treaties with the residence state.

States could prevent double taxation resulting from divergent application of the territoriality principle (in income tax terms: source vs source double taxation) through an international agreement on when a link to a certain state should be considered sufficient for taxation.⁸¹ For income taxes such coordination is probably not needed, as the issue should be solved if treaties with the residence state exist. For VAT, however, such coordination of rules seems desirable.

Next to value-added taxation by more than one state based on different assumptions concerning the place of consumption and consequently the application of diverging place of taxation rules, double taxation may also occur – even where the rules are similar – through different legal interpretation or different interpretation of the facts underlying a supply. The most common reasons for VAT double taxation (and in the inverse case double non-taxation) are therefore:⁸²

- the use of different rules to determine the place of taxation;
- different interpretation of (otherwise similar) place of taxation rules, the order of these rules, or a different interpretation of the surrounding key proxies and concepts for determining the place of taxation; and
- different characterization of a supply (even if similar rules are in place to determine the place of taxation) due to different interpretation of the underlying facts.

80. In a few cases, the problem can nevertheless be solved by the application of a non-discrimination provision like article 24 of the OECD Model, for example.

81. At the moment, however, even self-limitation of some states to tax only income sourced in their jurisdiction cannot fully prevent double taxation as these measures are not far-reaching enough and are not coordinated (see Vogel, *Einl.*, MN 32).

82. See OECD, *The Application of Consumption Taxes to the International Trade in Services and Intangibles – Progress Report and Draft Principles*, p. 3 (Feb. 2005); European Commission, *Consultation paper – Introduction of a mechanism for eliminating double imposition of VAT in individual cases*, 5 January 2007, TAXUD/D1/..., pp. 2-3; Erikson, *Should Tax Treaties Play a Role for Consumption Taxes?*, *Intertax*, p. 168 (2005); Millar, *GST Issues for International Services Transactions*, *Australian GST Journal*, p. 288 et seq. (2004); Millar, *Cross-Border Services*, p. 325; see also OECD, Working Party No. 24 of the Fiscal Committee, *First Report on Double Indirect Taxation*, 8 Apr. 1966, FC/WP24(66)1, p. 9 et seq.; Ruppe, *General Report*, p. 121 et seq., who also adds “[o]verlaps or gaps regarding the territory for which the right to tax is claimed” as another reason for non-taxation particularly.

While it is of course impossible to identify all possible situations of VAT double taxation in cross-border situations, I will nevertheless try to give some illustrative examples. Double imposition of VAT may, for instance, occur if one state levies VAT because it is the jurisdiction where the supplier is established and another state levies VAT because it is the jurisdiction where the recipient is established.⁸³

VAT double taxation may also occur if taxation in the jurisdiction where property is situated collides with the jurisdiction where the recipient is established. For instance, if an EU business rents a car in Switzerland for use in Switzerland for more than 30 days, Switzerland would consider the supply to be a supply of goods and levy tax because the car was in Switzerland at the time when it was put at the disposal of the customer.⁸⁴ At the same time under the general EU place of taxation rules, this would be considered a supply of services that under the basic rule of article 44 of the EC VAT Directive would be taxable in the state where the customer is located. Since the business customer is located in an EU Member State, this state may also tax the supply (i.e. if it has not implemented an effective use and enjoyment override for such cases).⁸⁵ The result would thus be VAT double taxation,⁸⁶ mainly caused by a different classification of the supply by the different states (i.e. supply of goods vs supply of services).⁸⁷

83. See e.g. OECD VAT/GST Guidelines, Preface, para. 7. To give an example, under the Ukrainian general rule, the place of taxation of services is where the supplier is registered (see Tymoshenko, *Ukraine*, in *The future of Indirect Taxation: Recent Trends in VAT and GST Systems Around the World – A Global Comparison* p. 533 et seq. (Ecker, Lang & Lejeune eds., 2012). The general B2B rule within the EU basically refers to the customer location.

84. See article 3(d) in connection with article 7(a) of the Swiss VAT Act; it should be noted, however, that the supply would be zero-rated if the car were directly delivered or transported out of Switzerland or predominantly used outside Switzerland (see article 23(2)(2) of the Swiss VAT Act).

85. Article 59a of the EC VAT Directive allows EU Member States to implement such an override. Some Member States, however, have not implemented such a measure with respect to the long-term hiring of means of transport used outside the EU (for an overview, see Van der Corput, *New EU VAT Rules Applicable from 1 January 2010* (2), Intl. VAT Monitor, pp. 14-15 (2010), while others have (e.g. Austria, see *Sec. 1 Verordnung des Bundesministers für Finanzen über die Verlagerung des Ortes der sonstigen Leistung bei der Vermietung von Beförderungsmitteln*, Federal Law Gazette (BGBl.) (1996/5)).

86. Of course in inverse cases, the result could be double non-taxation (see Gross, “*Leistungsort*” und “*Leistungsbegriff*” im Mehrwertsteuerrecht, *Archiv für Schweizerisches Abgabenrecht* 2005/2006, p. 348 et seq. (2005/2006)).

87. The basic rule for supplies of services under Swiss VAT law is similar to article 44 of the EC VAT Directive (see article 8(1) of the Swiss VAT Act).

VAT double taxation may further arise where a customer location rule collides with a place of use or performance rule. An example would be the interaction between Canadian and EU place of taxation rules on certain website services. The *Canada v. Dawn's Place* case decided by the Canadian Federal Court of Appeal⁸⁸ concerned a supply of access to a Canadian website whereby the recipient had the right to download and retain a copy of copyrighted material accessed on the website. The Canadian court decided that the place of taxation of such a supply was Canada. First of all, the supply was “made in Canada” because it was a “supply of intangible personal property that may be used in whole or in part in Canada” according to section 142 (1)(c)(i) of the Canadian Excise Tax Act.⁸⁹ Second, the court decided that supplies like the one in question were not zero-rated⁹⁰ under the Canadian Excise Tax Act.⁹¹ Consequently, the supply was to be taxed in Canada. If a user of the website were established in an EU Member State, the supply would also be taxed within the EU. Depending on whether that customer is a taxable person or not, such a supply would be considered a supply of services falling either under the basic place of supply rule for B2B supplies of services⁹² or under the special place of supply rule for electronically supplied B2C services.⁹³ In either case, the place of taxation under the EC VAT Directive would be in the EU Member State where the customer is established. Therefore, the supply would also be taxed within the EU. As a result, under such circumstances, there would be VAT/GST double taxation, in Canada and the EU.⁹⁴

Another example of double taxation (and in the inverse case non-taxation) would be where states use different fixed or permanent establishment concepts.⁹⁵ Some states, for instance, use fixed establishment concepts that are

88. Canadian Federal Court of Appeal, *Canada v. Dawn's Place Ltd (F.C.A.)*, 2006 FCA 349, [2007] 3 F.C.R. 521.

89. *Id.*, para. 15.

90. For simplicity's sake – although they are not completely identical – this book uses “zero-rated” as a synonym for “exemption with right for deduction”, “GST-free”, “exemption with credit”, etc.

91. *See id.* para. 19 et seq., especially para. 28. In the case at hand the crucial question was whether the supply could be considered a supply of copyright, which would have been zero-rated according to section 10, Part V, Schedule VI of the Canadian Excise Tax Act.

92. Art. 44 EC VAT Directive.

93. Art. 58 EC VAT Directive.

94. For other examples concerning double (non-)taxation with respect to digital supplies (including telecommunication services), *see* Rendahl, *Cross-Border Consumption Taxation of Digital Supplies*.

95. For simplicity's sake, this book only refers hereafter to fixed establishments. Unless referring to the concept in the legislation of a specific state (e.g. an EU Member

very similar to the permanent establishment concept used in the OECD Model.⁹⁶ Other states, like the EU Member States, use concepts that diverge from the OECD Model's concept.⁹⁷ As a consequence, there may be double taxation. One state may tax a supply because it considers it attributable to a fixed establishment situated within its jurisdiction. At the same time another state may consider the same supply taxable because – applying a different fixed establishment concept – it does not consider a fixed establishment to exist. As a consequence, the latter state may, for example, attribute the supply to a head office situated on its territory. An example of such a scenario can be seen in the European Court of Justice's (ECJ) decision in *Aro Lease* (Case C-190/95).⁹⁸ Although an intra-EU case, it illustrates how different conceptions of what constitutes a fixed establishment could lead to double taxation. In the case at hand, of course, there was a court (the ECJ) which decided on whether a fixed establishment existed and thus prevented double taxation. In an international context, however, such court does not exist.

Other examples concern real estate agent services where states may have different opinions whether and under which circumstances these services should be considered sufficiently connected to an immovable property to trigger the application of an immovable property location proxy.⁹⁹ Leasing supplies may also be problematic if states have different perceptions on

State), the term is also intended to cover similar concepts such as branch or permanent establishment which exist under other states' VAT regimes.

96. See e.g. Abbas & Cockfield, *Canada*, in *The Future of Indirect Taxation* p. 119 et seq., referring to section 123 of the Canadian Excise Tax Act.

97. For a more detailed discussion, see section 11.6.2.

98. ECJ, 17 July 1997, Case C-190/95, *Aro Lease* [1997] ECR I-4383; *Aro Lease* was a Netherlands company leasing cars in Belgium, among other places. The Dutch tax authorities did not assume there was a fixed establishment and therefore levied tax (see para. 6 of the decision) applying article 9(1) of the Sixth VAT Directive (Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, p. 1, OJ L145 (1977) (Sixth VAT Directive)). Article 9(1) basically provided for the supplier location proxy (which – if relevant – was superseded by a permanent establishment proxy). The Belgian tax authorities, on the other hand, assumed that the mere presence in Belgium of a fleet of cars owned by *Aro Lease* meant that the company had a fixed establishment in Belgium from which it supplied cars under leasing agreements. Therefore, the Belgian authorities also intended to tax (see para. 7 of the decision). In the end, the ECJ denied the existence of a fixed establishment, mainly because of the absence of the human resources necessary for the provision of the services. As a result, only the Netherlands was allowed to tax the leasing supplies.

99. See Millar, *Sources of Conflict in Cross-Border Services Rules for VAT*, Sydney Law School, Legal Studies Research Paper No. 08/14, January 2008, p. 21 et seq.

when a leasing supply should be considered a supply of goods or a supply of services.¹⁰⁰

But even where states' place of taxation rules theoretically correspond or are identical, there may nevertheless be double (non-)taxation based on a differing interpretation of the common rules. The number of such interpretative issues that are presented at the ECJ are evidence of this problem.¹⁰¹ Additionally, even if the content of the rules themselves may be clear, there may still be uncertainty about their order of precedence. Again, ECJ case law can serve as an example.¹⁰² Finally, double (non-)taxation may also have its origin in a differing interpretation of facts rather than a differing legal interpretation.¹⁰³

100. See e.g. Opinion of Advocate General Mazák, 30 Sept. 2010, Case C-277/09, *RBS Deutsche Holding*, case still pending. In this case, the German RBS Deutsche Holding leased cars to customers in the UK. The UK considered the leasing to be a supply of services falling under a supplier location rule (article 9(1) of the Sixth VAT Directive). In contrast, Germany considered the leasing to be a supply of goods falling under the scope of a location of goods rule (article 8(1) of the Sixth VAT Directive). As a result, none of the two states levied VAT on the leasing supply based on a different characterization of the supply (see paras. 20-21 of the Opinion). In the inverse case, i.e. a UK company leasing cars to German customers, the result would be double taxation. This is again an intra-EU case, but if such different interpretations occur even within the EU, it can be assumed that they will be even more of an issue with respect to non-EU Member States. For more examples, see also OECD, *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, para. 20 et seq. (2004).

101. See e.g. the above-described cases *Aro Lease* (Case C-190/95) and *RBS Deutsche Holding* (Case C-277/09, *RBS Deutsche Holding*, pending); see also e.g. ECJ, 27 May 2004, Case C-68/03, *Lipjes* [2004] ECR I-5879 concerning supplies of services by intermediaries (article 44 of the old EC VAT Directive before 2010); ECJ, 7 Sept. 2006, Case C-166/05, *Heger* [2006] ECR I-7749 on the supply of services connected to immovable property (article 47 of the EC VAT Directive); ECJ, 26 Sept. 1996, Case C-327/94, *Dudda* [1996] ECR I-4595 and ECJ, 9 Mar. 2006, Case C-114/05, *Gillan Beach* [2006] ECR I-2427 and ECJ, 12 May 2005, Case C-452/03, *RAL* [2005] ECR I-3947 on the supply of cultural, entertainment and similar services (article 52 of the old EC VAT Directive before 2010); ECJ, 17 Nov. 1993, Case C-68/92, *Commission v. France* [1993] ECR I-5881, ECJ, 17 Nov. 1993, Case C-69/92, *Commission v. Luxembourg* [1993] ECR I-5907, and ECJ, 17 Nov. 1993, Case C-73/92, *Commission v. Spain* [1993] ECR I-5997 on advertising services (article 59(b) of the EC VAT Directive); ECJ, 16 Sept. 1997, Case C-145/96, *Von Hoffman* [1997] ECR I-4857, ECJ, 27 Oct. 2005, Case C-41/04, *Levob* [2005] ECR I-9433, and ECJ, 6 Dec. 2007, Case C-401/06, *Commission v. Germany* [2007] ECR I-11295, on consultancy and similar services.

102. See e.g. ECJ, Case C-327/94, *Dudda*, especially paras. 20 and 21; ECJ, 15 Mar. 2001, Case C-108/00, *Syndicat des Producteurs Indépendants (SPI)* [2001] ECR I-2361; ECJ, Case C-114/05, *Gillan Beach*.

103. For more examples of VAT double (non-)taxation, see e.g. European Commission, *Report on the Outcome of the Consultation on "Introduction of a Mechanism for Eliminating Double Imposition of VAT in Individual Cases"*, 2007.

The VAT treaty conceptualized in this book is mainly designed to prevent double taxation caused by the use of differing place of taxation rules. However, it also provides for instruments to counter double taxation on grounds of the other reasons presented.¹⁰⁴ It is not primarily concerned with the elimination of VAT cascading, though. Next to the VAT-inherent reasons,¹⁰⁵ there may be additional reasons of tax cascading in cross-border situations. One reason could be legal or factual limitations for cross-border refunds. A recent OECD survey shows that more than 80% of businesses cannot recover all of their foreign VAT.¹⁰⁶ Not all countries provide for refund procedures and some countries require reciprocity in order to grant a refund.¹⁰⁷ Other issues seem to be language, communication with the authorities (including guidance, forms and procedures), and speed of repayment. As a result, more than half of the businesses that responded to the OECD survey have outsourced the management of foreign VAT claims and again half of the businesses have stopped claiming VAT in some countries, citing “the amounts incurred are not worth the trouble.”¹⁰⁸ If a business cannot get a refund, the non-refunded tax will most likely become part of the price of (again taxed) output supplies. Another reason for VAT cascading could be that a business is input taxed¹⁰⁹ in the state where it receives supplies but nevertheless taxable on output supplies in a state where it renders its output supplies. Tax cascading is most likely to occur in such a case.

While the VAT treaty conceptualized in this book is not primarily concerned with tax cascading, it may nevertheless help in abating this problem. In particular, the extensive use of the destination principle combined with a reverse charge mechanism should mitigate problems connected with cross-border refunds. Furthermore, if the treaty is directly applicable – i.e. the losing state does not levy VAT in the first place instead of first levying tax and then giving a refund – there is no risk of non-refundable tax in the

104. See especially the mutual agreement procedure presented in section 20.2.

105. E.g. if an input taxed supply (i.e. a supply for which no input VAT could be deducted, for instance, because it is supplied by a non-taxable person or is used for input taxed supplies) is rendered to a business that uses these supplies to render taxed business supplies.

106. See OECD, *VAT/GST Relief for Foreign Businesses: The State of Play – A Business and Government Survey* (February 2010).

107. See Eriksen & Haydl, pp. 1146-1147.

108. See OECD, *VAT/GST Relief for Foreign Businesses: The State of Play – A Business and Government Survey*, e.g. pp. 5 and 15.

109. “Input taxed” means that supplies are exempt without giving right for input VAT deduction or credit.

losing state. Tax treaties could also be used to foster recoverability of tax, e.g. through the inclusion of a reciprocity clause for refunds.¹¹⁰

2.4. Intra-Community double (non-)taxation outside scope of book

This book does not cover cases in which merely EU Member States are involved. It only addresses the question of double taxation between an EU Member State and a non-EU Member State as well as between two non-EU Member States.¹¹¹

As VAT is harmonized within the EU, it is not surprising that the risk of double (non-)taxation is not as prevalent between the Member States as it may be between Member States and third countries. And if, despite the harmonized rules, VAT double taxation occurs within the European Common Market, it is usually the responsibility of the ECJ to solve this issue.¹¹² The EU is special because of the general absence of internal frontiers. A study on double taxation and possible remedies within the EU would therefore require a different scope than in a non-EU context.

It is interesting to note, however, that the disparities of VAT regimes and consequently also the negative effects of double (non-)taxation were quickly picked up by the EU Member States. Already in the early days, they realized that the harmonization of VAT rules and the prevention of double taxation were a necessary requirement for the implementation of an inter-

110. See also Eriksen & Haydl, p. 1158.

111. The question as to who has the power to conclude treaties in an EU context is not treated in this paper. Further research is needed to assess whether the EU Member States still have the power to negotiate and conclude VAT/GST treaties. As VAT is harmonized within the European Union, it may be that this power now lies with the European Commission. It further has to be analysed whether the EU Member States even have the power to discuss and agree on a VAT/GST model convention, e.g. in an OECD context.

112. See e.g. European Commission, *Consultation paper – Introduction of a mechanism for eliminating double imposition of VAT in individual cases*, p. 35 (January 2007); a different interpretation of facts, however, may still lead to double taxation. For this reason, the Commission proposes the introduction of a mutual agreement and arbitration procedure in these cases (see same document).

nal market.¹¹³ Current EU Commission initiatives¹¹⁴ and ECJ case law¹¹⁵ confirm that this has not changed and that VAT double taxation is still an undesirable constraint to the internal market. This is further evidenced by the existence and recent extension of the place of effective use and enjoyment override in articles 59a and 59b of the EC VAT Directive which EU Member States may or must implement “[i]n order to prevent double taxation [and] non-taxation.”¹¹⁶

113. See also Pistone, *Soft Tax Coordination: A Suitable Path for the OECD and the European Union to Address the Challenges of International Double (Non-)Taxation in VAT/GST Systems*, in *Value Added Tax and Direct Taxation – Similarities and Differences* p. 1161 (Lang et al. eds. & Ecker ass. ed., 2009).

114. See e.g. European Commission, *Consultation paper – Introduction of a mechanism for eliminating double imposition of VAT in individual cases* (5 January 2007).

115. See e.g. ECJ, 11 Sept. 2003, Case C-155/01, *Cookies World* [2003] ECR I-8785; see also ECJ, 21 May 1985, Case C-47/84, *Gaston Schul* [1985] ECR 1491 and ECJ, 25 Feb. 1988, Case C-299/86, *Drexel* [1985] 1213, both with respect to tax cascading on imports before the implementation of the transitional measures applicable for intra-Community operations.

116. For more details, see especially section 11.1.2.

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