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VAT and the Digital Economy: The Untold Story of Global Challenges

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In this article, the authors examine how the VAT applies in the digital economy and provide a general guide for companies looking to comply with VAT rules for digital goods and services, from the fundamental challenges of the digital world to the newest challenges presented by cutting-edge technologies and changing business models.

Not so long ago, neither the VAT, also known as a goods and services tax, nor the internet existed. Then the French[1] dared to implement a new form of taxation that spread across the globe and became so popular that more than 165 jurisdictions use it as a steady source of revenue. The idea is simple: tax consumption rather than income and require domestic businesses to collect the tax on behalf of the government on domestic sales of goods and services. Then the Big Bang occurred. Thanks to the internet, sellers of goods and services gained immediate access to a global market, and the World Wide Web rapidly became the town square for the global village. Today, a company operating from a garage in Palo Alto, California (or any place with a decent internet connection), can sell digitized products to millions around the globe without a single sales representative setting foot on foreign soil.

The growing digital economy exposed the logical cracks in VAT rules built for a bricks-and-mortar economy, and countries became concerned about a loss of revenue because the existing VAT rules did not tax consumption of digital products in the country of consumption. As countries began to modify their VAT laws to face these new challenges, e-commerce providers became global tax citizens, dragging traditional businesses into the global tax net with them.

This article is intended to be a guide to assist businesses in understanding the new VAT rules applicable to digital goods and services, identifying when they may have VAT obligations, understanding compliance requirements, and guarding themselves against other potential pitfalls.

Digital Economy VAT 101

As a consumption tax, a VAT traditionally applies where consumption occurs, based on the

[1] Liam Ebrill et al., *The Modern VAT* 4 (2001).

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destination principle.[2] In cross-border transactions involving tangible personal property, this is achieved by not taxing exports and by imposing a VAT at the port of entry. Traditionally, most jurisdictions exempt the importation of low-value goods (LVG) by final consumers from the VAT because the cost of administration is considered greater than the potential revenue.[3] Applying the destination principle to services and intangibles is more challenging because of the difficulty in identifying the jurisdiction of consumption and the compliance obligations that could confront a multijurisdictional seller. Generally, most jurisdictions have applied the following rules to sales of services and intangibles:

- for business-to-business (B2B) transactions, VAT is due in the country of the customer; and
- for business-to-consumer (B2C) transactions, VAT is due in the country of the vendor.

These rules were developed when most VAT systems were first implemented, when consumers primarily acquired goods and services from domestic vendors. At that time, the places of sale and consumption were generally located in a single jurisdiction. For B2C transactions, the location of the vendor was a reasonable proxy for the place of consumption since the effect of not imposing VAT on cross-border services was minimal because the volume of transactions was insignificant. The same reasoning applied to the exemption of B2C imports of LVG.

The digital revolution disrupted traditional business models. Now, the VAT revenue forgone by not taxing cross-border sales of digital goods and services generated serious concerns for many tax authorities worldwide. For example, in 2015 New Zealand estimated that it suffered an annual VAT leakage of NZD 180 million ($114 million) because of cross-border services, intangibles, and goods.[4] While the EU partially addressed these challenges in 2003,[5] it was not until late 2015 that the OECD published its updated International VAT/GST Guidelines,[6] which were endorsed by more than 100 jurisdictions. The guidelines endorse the destination principle as an international norm and recommend that B2B and B2C transactions be taxed in the country where the customer is established, except on-the-spot B2C services such as personal services, accommodations, and restaurants, which should be taxed where the service is rendered. The guidelines also recommend that services involving immovable property should be taxed where the property is located. For B2C services, the guidelines recommend that the nonresident vendor should register for and charge a VAT in the country where the consumer is located. For B2B services, the guidelines suggest that the business recipient should self-assess VAT using a reverse charge or similar mechanism.

The OECD guidelines seem to have jump-started the process of adapting VAT/GST rules to meet the challenges of the digital economy. Many countries have implemented new rules that largely conform to the OECD guidelines (or are in the process of doing so), including Albania, Australia, the Bahamas, Belarus, Colombia, the 28 member states of the EU, the six member states of the Gulf Cooperation Council, Ghana, Iceland, India, Japan, Kenya, New Zealand, Norway, Serbia, South Africa, South Korea, Switzerland, Taiwan, and Tanzania. Experts expect that the number of countries adapting their VAT/GST laws to address the challenges of the digital economy will only grow.

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[2]For a discussion of why destination-based taxation is preferable, see Michael Keen and Walter Hellerstein, "Interjurisdictional Issues in the Design of a VAT," 63 *Tax Law Rev.* 359, 365-366 (2010). *See also* Ebrill et al., *supra* note 1, at 177-184.

[3]*See* Laura Mattes, "VAT Aspects of Cross-Border Transactions in the BEPS Era," 3 *Int'l VAT Monitor* 176 (2016).

[4]New Zealand Inland Revenue, "GST: Cross-Border Services, Intangibles and Goods" (Aug. 2015).

[5]Before 2015, the EU required non-EU businesses to register for and charge VAT in the member state of consumption on sales of electronically supplied services to EU consumers. However, these rules were not applicable to EU businesses making identical sales. In 2015 the EU harmonized the VAT treatment of these sales, requiring all B2C vendors of telecommunications, broadcasting, and electronically supplied services to register for and charge VAT in the member state of consumption. *See, e.g.*, Philippe Stephanny, "Upcoming 2015 Changes in EU Sourcing Rules for Electronic Supplies, Broadcasting, and Telecommunications Services," 23 *BNA Daily Tax Rep.* J-1 (Feb. 4, 2014).

[6]OECD, "International VAT/GST Guidelines" (Nov. 2015).

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Identifying Foreign VAT Obligations

Companies involved in the cross-border sale of services or intangibles must carefully perform a detailed analysis to determine their potential foreign VAT obligations. For simplification purposes, we will refer to these as sales of digital services because most new rules are aimed at these types of products and services. Examples of digital services include downloaded or streamed books, music, and movies; online games; software; and telecommunications services. However, the scope of these services may be even broader, as discussed below.

The order of the following steps may vary depending on the information available to a company. We suggest first identifying countries where sales are made, establishing and maintaining a good understanding of the business supply chain. This approach allows companies to quickly consider a large number of jurisdictions.

For instance, if a company sells only to countries in Latin America, the underlying VAT risk will likely be low (at least for now), and the company would have only to monitor developments in the region. On the opposite end of the spectrum, if a company makes sales to EU countries, the VAT risk is higher, and the company will have to carefully assess the possible VAT obligations arising from its transactions.

Step 1: Identifying Where Sales Are Made

The first step for any company involved in digital sales is to establish a list of countries where sales are made. This list is the basis for further analysis, and the company should review and update it regularly as new jurisdictions introduce rules for digital sales.

The company should categorize the jurisdictions, identifying those that have implemented rules for digital sales, those expected to implement rules soon, and those that are considering changes in the longer term. This will help the company focus on those transactions that pose the most immediate risk. While this approach identifies most jurisdictions in which a foreign VAT obligation for sales of digital services may arise, an obligation may also arise elsewhere under existing VAT/GST rules not specific to digital services. In Canada, for example, under the general GST rules, a nonresident vendor that has a permanent establishment in Canada is treated as a resident and typically must register and collect GST for the activities carried on through that PE. Moreover, a nonresident without a PE may be required to register for GST purposes if it is considered to be "carrying on a business in Canada" based on a 12-factor test.[7] For this reason, businesses should perform a somewhat abbreviated second-level verification of jurisdictions that do not have specific digital sales rules.

Finally, businesses should be aware that determining where sales are made for VAT/GST purposes may require identifying customer locations, which can be complicated, as we discuss in a later section on compliance obligations. When evaluating countries with potential sales, businesses should first use readily available data to broadly identify whether a potential foreign VAT obligation exists. Later, businesses should consider the complex compliance rules and verify whether other VAT liabilities exist.

Step 2: Determining Which Entity Must Comply

Once a business has identified the countries where it sells digital services, it should review its supply chain and determine whether the company itself or a third party is liable for compliance with the VAT requirements. Many countries have enacted rules for sales involving intermediaries, especially electronic marketplaces. Under these rules, sales via an e-marketplace are deemed to be carried out by the e-marketplace, not by each individual vendor, thereby shifting the VAT liability (and compliance obligations) from the vendor to the e-marketplace.

Approaches to the taxation of the intermediaries may vary among jurisdictions and be based on precise contractual terms. For instance, both the EU and Australia have rules that deem an intermediary involved in "key aspects of the sale" to be the vendor, but they apply their rules differently. Under the EU

[7] *See* Canada Revenue Agency, "Carrying On Business in Canada," GST/HST Policy Statement P-051R2 (Apr. 29, 2005).

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approach, each transaction in the supply chain is examined and, for each transaction, each entity is deemed to have received and resold the digital service itself (reseller assumption).[8] Thus, an e-marketplace operator involved in key aspects of the sale to the final consumer is required to account for a VAT. In assessing whether a taxable person is involved in key aspects of the sale, facts and legal relationships must be considered. The EU explanatory notes provide guidance and examples of factors that suggest involvement, such as owning the online platform, controlling or influencing pricing policy, and owning customer data.[9] The reseller assumption can be rebutted if both the facts and the contractual arrangements between the relevant parties demonstrate that the individual vendor and not the e-marketplace is rendering the service. Moreover, a payment service provider that merely processes the payment for the provision of e-services (for example, a credit card company) is not subject to the assumption in the EU.

In contrast, under Australian rules,[10] an e-marketplace is treated as the vendor of inbound intangible B2C sales, but this treatment does not extend to deeming the intermediary to have acquired the digital content. Furthermore, under Australian rules, each service provided by the operator of the e-marketplace, such as agency or a facilitation service, is treated separately in accordance with the business agreements.[11]

Finally, businesses should note that some jurisdictions may have implemented joint and several liability for vendors and e-marketplaces, which may drag them both into the VAT net.

Step 3: Identifying Digital Services

If a company determines that it may be required to comply with foreign VAT rules, it should then analyze whether the products sold fall under the definition of digital services in the countries where the sales are made. The scope of services falling under these rules varies greatly.

As always, the devil is in the details, and what is a taxable transaction in one jurisdiction may not be in others. Businesses must closely analyze the statutes and regulations of the country where the foreign customer is located to be certain whether the VAT e-commerce rules apply to their transactions. For example, unlike most jurisdictions with digital service rules, South Africa does not include the sale of software in the definition of digital services.[12] However, in its 2017 budget, South Africa stated that it would review the list of e-services and will likely add software and cloud computing.

Some jurisdictions have adopted a relatively narrow definition of digital services. In South Korea, for example, the rules on digital services apply only to limited content-oriented transactions, such as those involving games, video files, electronic documents, software, and similar items and their upgrades processed by optical or electronic means.[13]

The definition of digital services in the EU[14] is broader — services delivered over the internet or via an electronic network that:

- are essentially automated;
- involve minimal human intervention; and
- cannot be delivered without IT.

The EU legislation provides a long, non-exhaustive list of items that are and are not considered digital services. The positive examples include five broad categories of e-services (specifically, web hosting; software; image, text, and database services; media content; and

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[8] Council Implementing Regulation (EU) No. 1042/2013 of Oct. 7, 2013, amending Implementing Regulation (EU) 282/2011 regarding the place of supply of services, at article 9a. *See also* Teck Chin Lim, "Introducing the 'Netflix Tax' in Singapore: The Antipodean and European Approaches," 101 *Taxation Today* 19-20 (Dec. 2016).

[9] European Commission, "Explanatory Notes on the EU VAT Changes to the Place of Supply of Telecommunications, Broadcasting and Electronic Services That Enter Into Force in 2015" (Apr. 3, 2014).

[10] A New Tax System (Goods and Services Tax) Act 1999 (Australia).

[11] Australian Taxation Office, Discussion Paper TDP 2016/1, "Discussion Paper on Issues Concerning Electronic Distribution Platforms" (Dec. 6, 2016).

[12] *See* Value-Added Tax Act No. 89 of 1991, South Africa, "Regulations Prescribing Services for the Purpose of the Definition of 'Electronic Services'" (Mar. 2014). *See also* South African Revenue Service, "VAT Registration Guide for Foreign Suppliers of Electronic Services" (Sept. 2015).

[13] Dong Suk (Daniel) Kang, "New VAT Registration for Overseas Electronic Service Providers," KPMG Korea (2015).

[14] Council Regulation (EC) 1777/2005 of Oct. 17, 2005, laying down implementing measures for Directive 77/388/EEC on the common system of VAT [2005] JO L288/1.

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distance teaching). The negative examples include professional services provided over email; advertising services in newspapers, posters, and television; distance learning in which content is delivered electronically (akin to correspondence courses); and so forth. While telecommunications and broadcasting services fall under different definitions, the B2C place of supply rules that apply to e-services also apply to telecommunications and broadcasting services — all sometimes referred to as TBE services. Therefore, the scope in the EU may be considered broader as in other jurisdictions that focus exclusively on e-services.

Other jurisdictions take a less specific approach and more closely follow the OECD guidelines. Australia, for example, does not try to define a specific subcategory of digital services, but rather states that all sales of services and intangibles made to Australian consumers are prima facie subject to GST.[15] Therefore, although primarily aimed at digital services, the rules capture more traditional services such as consulting and advertising. In a proposal published in December 2016, the European Commission recommended adopting an approach similar to that in Australia and New Zealand, namely taxing all B2C services where the consumer is located, unless a specific exception applies.[16]

Identifying whether a service is taxable may not be sufficient. Some jurisdictions apply a reduced VAT rate to specific products (for example, e-books) or deem transactions VAT-exempt if specific conditions are met (for example, education or gambling). The taxation of bundled sales (for example, tangible property in combination with digital services) may create additional challenges for determining the applicable VAT treatment.

Step 4: Determining the Type of Customer

Once a company identifies a transaction as falling within the scope of digital services rules, it must then determine the status of the foreign customer because, generally speaking, there are different rules and implications for B2B and B2C transactions.

Properly categorizing the customer is, unfortunately, not necessarily simple. First, countries differ significantly in how they define a business and a final consumer. In general, most jurisdictions (for example, the EU, Australia, and New Zealand) consider a final consumer to be a private individual not registered for VAT purposes. Jurisdictions may also include in this category other non-VAT-registered entities such as public bodies (as in India and the EU) or nonprofit organizations (as in the EU).

In practice, vendors are generally required to identify the status and location of their customers on a transaction-by-transaction basis based on information collected through their ordinary business processes. Under EU rules,[17] for example, the primary evidence required to identify an EU-based business customer is the VAT identification number verifiable through the European Commission's portal, but alternative evidence (for example, a letter from the tax authority, tax reference number, or company registration documents) may be acceptable. Australia and New Zealand also rely on GST registration numbers to identify whether a customer is a business, but both countries also make the customer responsible for providing accurate information on its status to the nonresident vendor and impose penalties on customers who provide false information to avoid the GST.[18]

Japan, which does not use a VAT identification number system, presents a unique case because the classification of a B2B or B2C transaction is based on the product or service involved in the transaction. According to Japanese rules,[19] if a service can be used by private consumers, then the transaction qualifies as a B2C sale, even if the sale is to a Japanese business. For example, a sale of an e-book would be B2C even if the actual

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[15] *Supra* note 10, at section 38-190(3).

[16] European Commission, "Modernizing VAT for Cross-Border B2C E-Commerce," COM(2016) 757 final 2016/0370 (CNS) (Dec. 12, 2016).

[17] Council Implementing Regulation (EU) No. 282/2011 of Mar. 15, 2011, laying down implementing measures for Directive 2006/112/EC on the common system of VAT [2011] OJ L77/1.

[18] Taxation Administration Act 1953 (Australia), section 284-75(4); and Goods and Services Tax Act 1985 (New Zealand), section 60C.

[19] *See* National Tax Agency Japan, "Revision of Consumption Taxation on Cross-Border Supplies of Services" (May 2015).

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customer was a Japanese business. Likewise, Japanese law defines B2B transactions as digital services that are normally limited to businesses based on the nature of the services or the terms and conditions of the transaction. These services include online advertising, intermediary services for online sales of games and applications, online booking services provided to a hotel or restaurant by a website operator, or individually negotiated cloud services intended for the recipient's business use.

In most jurisdictions, a nonresident vendor is liable for the VAT only in B2C transactions. In these jurisdictions, the purchaser in a B2B transaction usually accounts for the VAT using a reverse charge mechanism. Under the reverse charge mechanism, the business customer is liable to self-assess VAT, thus shifting the liability to collect and remit VAT from the vendor to the purchaser. Any self-assessed VAT should be recoverable by the business customer, provided he makes taxable sales. However, in some jurisdictions (for example, South Africa), both B2B and B2C transactions trigger nonresident VAT liability. In other places (Russia[20] is one example), even when VAT liability for B2B transactions is shifted to the business customer, the transaction may be subject to a VAT withholding mechanism. Under a withholding system, the sales price is considered VAT-inclusive. The business customer withholds the VAT on the government's behalf, effectively reducing the consideration received by the nonresident vendor. This mechanism may also apply to B2C transactions. Colombia, for instance, is considering a VAT withholding scheme for B2C transactions in which financial institutions through which purchases are made would be required to withhold the applicable VAT.[21]

Step 5: Determining the Registration Threshold

Next, a company must determine whether its level of sales triggers a VAT registration requirement. The approach to registration thresholds and the types of sales that count toward its computation vary greatly. Thresholds range from nil (as in the EU and Russia), to low (for example, ZAR 50,000 ($3,413) in South Africa),[22] to high (for example, $100,000 in the Bahamas).[23]

Businesses must also consider the types of sales that should be included in the VAT/GST threshold computation. In New Zealand, remote services provided by a nonresident to New Zealand GST-registered businesses do not count toward the registration threshold because they are outside the scope of the tax. In Switzerland, effective 2018, worldwide sales will be taken into consideration in computing the threshold.[24] Consequently, a single B2C sale in Switzerland may trigger a registration obligation if sales elsewhere exceed the threshold.

In the EU context, the current regime for taxing cross-border electronic services imposes a significant compliance burden on small businesses (both EU and non-EU) because the registration threshold differs for domestic and foreign vendors. Vendors outside the country of consumption are, under all circumstances, required to register for the VAT for digital sales made to final consumers established or resident in the EU. Some member states, such as the U.K.,[25] implemented unilateral measures to relieve the compliance burden placed on small businesses by this rule. In December 2016 the European Commission proposed modernizing VAT rules for cross-border e-commerce.[26] Under this proposal, effective January 1, 2018, an EU company with annual cross-border sales of less than €10,000 would be allowed to treat these sales

[20] *See* KPMG, "Russia: VAT on the Supply of E-Services, Effective 2017" (Sept. 19, 2016).

[21] *See* Law 1819 of 2016 (Colombia) (Dec. 29, 2016) (providing for structural reform of the Colombian tax system). The law was passed with an implementation date of July 1, 2018. However, detailed regulations on the implementation have yet to be published.

[22] South African Revenue Service, "VAT Registration Guide for Foreign Suppliers of Electronic Services" (Sept. 2015).

[23] *See* Government of the Bahamas Online Tax Administration, "VAT – Registering a Taxpayer."

[24] *See* KPMG, "Switzerland: VAT Provisions Approved, Effective Beginning 2018" (Oct. 3, 2016).

[25] HM Revenue & Customs (U.K.) Brief 4/16, "VAT MOSS – Simplifications for Businesses Trading Below the VAT Registration Threshold" (Feb. 5, 2016).

[26] *Supra* note 17. The commission is working on this proposal during the summer and will likely have an updated version out in September. For the proposal to pass, the European Council must unanimously approve it. Based on recent news articles, it seems that all EU member states agree that the rules must be updated and thus the chance for the proposal to pass in the relative near future is great.

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akin to domestic sales, and therefore deal only with its national tax authority. Thus, instead of using the VAT mini one-stop shop (MOSS), which allows a nonresident to register in one member state for the collection of VAT on digital services in all EU member states, or registering in each country where it makes sales, a small EU seller would be able to apply the familiar VAT rules of its home country, including invoicing requirements and recordkeeping. This threshold, however, would not apply to non-EU businesses, which would still be required to register for the VAT regardless of their sales volume.

Understanding VAT Compliance Rules

After identifying countries in which they are required to register, companies must understand their new compliance obligations.

Registering

As would be expected, jurisdictions vary in their approach to registration, and some require a vendor to appoint a fiscal representative. New Zealand and Russia, for example, have introduced a simplified registration process for nonresident vendors of digital services. The vendor is liable to report taxable sales in its future VAT return, but may not claim any VAT incurred on expenditures.

The EU introduced the VAT MOSS to alleviate the registration burden on companies. This simplified registration scheme allows EU vendors providing B2C sales of telecommunications, broadcasting, and electronically supplied services to register in a single member state (referred to as the member state of identification) and report all the sales made to the other member states (referred to as the member states of consumption). The state of identification is responsible for distributing remitted taxes to the member states of consumption. However, the incomplete harmonization of EU and MOSS rules prevents non-EU businesses that are already registered for VAT in one member state from registering under MOSS for their sales of services across the EU. Instead, non-EU resident vendors must register in each member state in which they make B2C sales. The EU VAT modernization proposal would address this issue and allow a non-EU business with a VAT registration in a member state to qualify for MOSS registration. The proposal also would extend MOSS to all B2C sales of services and goods.

Other jurisdictions require full VAT registration (that is, sales and purchases must be reported), which demands more supporting information and more time than a simplified registration. In Switzerland,[27] for instance, once a company reaches the registration threshold, all sales to Swiss customers (not only B2C sales, but also B2B sales) become subject to the Swiss VAT.

Finally, in several jurisdictions (for example, Japan and Switzerland),[28] a nonresident entity may not register directly with the tax authority and must appoint a local person to act as fiscal representative, who will generally be held jointly and severally liable for tax obligations. In Japan, a foreign business must complete and submit a registration form, attaching evidence that it either has an office associated with B2C electronic services in Japan or has appointed a qualified agent in Japan (for example, a tax accountant). If a foreign business does not satisfy these conditions, it is not able to register directly.

Filing of Returns

Companies should also be aware that the rules for taxing digital services differ significantly as to when and how VAT/GST returns must be filed and what information they must include. The filing periods could be monthly (South Africa), bimonthly (Iceland), quarterly (New Zealand), or semi-annually (Japan), and in some cases depend on the taxpayer turnover and type of business conducted. Filing deadlines for these returns can be extremely short. In the EU, for instance, businesses must file MOSS returns quarterly and submit them within 20 days from the end of the filing period.

Short filing deadlines, combined with strict rules against not filing timely returns, create added pressure on businesses that may face challenges in gathering all the information required to file. To simplify compliance under

[27] *See* Federal Tax Administration (Switzerland), 641.20 Federal Act of June 12, 2009, on Value Added Tax; and 641.201 Ordinance of November 27, 2009, on Value Added Tax.

[28] *Id.* See *also* National Tax Agency Japan, "Information About Consumption Tax."

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MOSS, the EU VAT proposal extends the filing deadline from 20 days to 30 days after the end of the quarterly tax period.

Many jurisdictions have implemented electronic platforms to allow companies to submit online returns. A company providing digital services should consider the specific information that the VAT/GST return must include, as the requirements differ greatly within jurisdictions. These information requirements must be properly set up in the company's enterprise resource planning (ERP) system and, if applicable, the tax engine to ensure full compliance with the various VAT/GST laws.

Invoicing

A few jurisdictions also establish invoicing requirements. In India and South Africa, for instance, nonresident vendors registered for the VAT and that sell taxable digital services must issue VAT-compliant invoices meeting specific requirements (for example, providing the name of the vendor and separately stating the amount of tax). Full compliance with these requirements can be ensured only if the requirements are implemented in a company's ERP system and online sales portal, meaning they may affect the customer experience.

The lack of harmonization across jurisdictions as to invoicing requirements further increases the compliance burden on businesses. This has pushed the EU to include in its VAT modernization proposal a rule imposing (via the VAT MOSS) the invoicing requirements of the state where the vendor is registered rather than those of each state of consumption.

Identifying the Customer's Location

Several jurisdictions have introduced rules for identifying a customer's location to determine the jurisdiction to which the sale will be assigned for tax purposes. For example, the EU rules for B2C digital services include a set of rebuttable presumptions for specified transactions.[29] For all other digital transactions, a business must determine the customer location based on two noncontradictory pieces of evidence, such as customer billing address, IP address, bank details, country code of the SIM card used, and location of a residential fixed landline. Under these rules, many vendors must gather and retain two or three pieces of information for each customer in up to 28 member states. This information is not always readily available, further increasing the compliance burden. Therefore, the EU VAT modernization proposal suggests a gross receipts threshold of €100,000, under which businesses can presume the customer's location based on only one piece of evidence. Under the current proposal, only EU-established businesses would be eligible for this reduced burden.

India and Belarus have implemented similar rules, but with some differences in the evidence that sellers may use to determine the customer location. In India, for example, a consumer will be deemed established in that country if two of seven listed conditions are satisfied (such as address in India, credit card issued in India, or IP address in India).[30] In Belarus, an individual purchasing digital services is deemed to be in Belarus if at least one of the following conditions is met:

- the individual is resident in Belarus;
- payment is made through a bank or e-payment operator in Belarus;
- the individual used a Belarusian IP address to purchase digital services; or
- the individual used a Belarusian telephone number to purchase digital services.[31]

Complying with these requirements may be challenging for businesses because they probably are not collecting the necessary evidence. Finally, different pieces of evidence may result in a customer being deemed to be in two taxing jurisdictions and a business would have to justify why one jurisdiction should be preferred to the other. This can be an issue when a transaction involves two jurisdictions with very different approaches. For instance, a sale will be considered taxable in Australia if it is connected with the country, a standard that is interpreted broadly. That same transaction may be subject to an EU

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[29] Council Regulation 1042/2013, *supra* note 8.

[30] KPMG LLP, "India: Nonresident E-Services Providers Required to Register for Service Tax Effective December 1, 2016," *Inside Indirect Tax* (Dec. 2016).

[31] KPMG LLP, "Belarus: VAT on Remote Electronic Services Effective January 1, 2017," *Inside Indirect Tax* (Nov. 2016).

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VAT if, based on the evidence collected, the consumer is deemed to be in an EU member state.

Belarus has developed an approach to avoiding double taxation, at least with the EU. If digital services are deemed to be provided in Belarus under its tax laws and simultaneously deemed to be provided at the vendor's location under the laws of an EU member state, then the services will be sourced to the EU state. If this occurs, the foreign entity must file a notice with the Belarusian tax authority informing it of the type of electronic service involved and referencing both the national and the EU legislation.

Other Compliance and Noncompliance Issues

Businesses should consider what recordkeeping requirements are triggered when registering for a VAT/GST. Format, location, and length of these requirements vary among jurisdictions. In the EU, registration under MOSS triggers a 10-year recordkeeping obligation,[32] far beyond the average requirements throughout the EU. For that reason, the EU VAT proposal would replace the 10-year period with the recordkeeping period in the member state of identification.

Businesses should also consider the effect the VAT/GST will have on pricing and the customer experience. This is especially important when a vendor sells B2B and B2C and must decide whether prices should be the same for both types of sales. Businesses should review contracts and general terms and conditions after VAT/GST obligations are triggered to clarify the obligations of each party, especially when the law provides for a tax-inclusive computation, as in Russia.

Finally, businesses should be aware that because these rules are relatively new, guidance regarding audits of nonresident vendors of digital services is relatively sparse. Given that the VAT enforcement authority remains with the member state of consumption, taxpayers may be subject to multiple audits in multiple jurisdictions, with different administrative procedures, involving different rules, and carrying different penalties. Although there is not a significant body of audit-related rulings involving digital goods and services, tax authorities have begun assembling teams to target nonresident vendors of digital services. For instance, on June 1, 2016, the German Federal Financial Court held that a U.S.-based online dating platform was subject to a VAT in Germany because it provided digital services to German customers.[33]

Enforcement of these new rules may lead to increased cooperation and information exchanges among tax authorities, using conventional vehicles such as tax information exchange agreements or possibly treaties regarding cooperation in VAT/GST matters. The EU is working to improve collaboration among tax authorities within the EU as well as non-EU jurisdictions that also have VAT systems. In early June 2017, the European Commission announced that it had successfully completed the negotiation of an agreement between the EU and Norway on administrative cooperation, recovery assistance, and fraud prevention efforts regarding VAT.[34]

Low-Value Goods: The Final Frontier?

For simplification reasons, many countries exempt the importation of goods with a value under a specified threshold (for example, between €10 and €22 in the EU, approximately $11 to $23; and AUD 1,000 in Australia, approximately $760) because the administrative and compliance costs would exceed the VAT collected.

The problem is that the significant growth in the importation of exempt LVG is allegedly affecting domestic brick-and-mortar retailers and reducing tax revenue. In the EU, the number of small consignments — items falling under the exemption threshold — that entered from outside the EU rose from 30 million in 1999 to almost 115 million in 2013.[35] In Australia, the total volume of air cargo imports reported for 2009-2010 was 11.2 million consignments, with a majority of items falling under the LVG threshold. One year later,

[32]EU VAT Directive, *supra* note 17.

[33]Bundesfinanzhof [Supreme Tax Court], XI R 29/14 (June 1, 2016) (published Sept. 7, 2016). *See also* William Hoke, "U.S.-Based Online Dating Platform Is Subject to VAT, German Court Says," *Tax Notes Int'l*, Sept. 19, 2016, p. 1024.

[34]European Commission, "EU-Norway Agreement on VAT Cooperation Initialed" (May 2017).

[35]European Commission, "Assessment of the Application and Impact of the VAT Exemption for Importation of Small Consignments" (2015) (executive summary also available).

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the total volume of air cargo imports rose to 13.9 million consignments.[36] In the BEPS action 1 final report, the OECD has proposed four options to address this situation. The vendor collection model, under which the nonresident vendor must charge, collect, and remit the VAT in the country of importation, appears to be preferred by most countries that have implemented rules on this topic.

Australia will become the first country to apply a GST to the importation of LVG, effective July 1, 2018. Australia's law requires either the vendor, the e-marketplace, or the freight carrier (depending on the specific facts and circumstances) to collect the import GST on these transactions.[37] The EU VAT proposal includes provisions extending the VAT MOSS mechanism to the import of LVG and holding the carrier liable for the import VAT under specified circumstances.[38] Meanwhile, the U.K. has taken a unique approach to fighting VAT fraud involving LVG that could be followed by other countries. Since 2016, online marketplaces that allow U.K. consumers to view and order goods being offered for sale by overseas businesses may be held jointly and severally liable for VAT that is not paid by the overseas business.[39] The Russian Federal Antimonopoly Service is working on legislation to impose a VAT on goods sold by foreign online retailers to Russian consumers.[40] On June 2, the Swiss Federal Council announced that amendments to its VAT computation threshold for mail-order companies would be delayed.[41] Starting January 1, 2019, a mail-order company will be liable for tax in Switzerland if its annual turnover from small consignments that are import-tax-free is at least CHF 100,000 (about $104,000). Such mail-order companies will bill customers for the VAT, and the customers will no longer have to pay the taxes and fees levied by customs upon importation.

These new rules, and others like them, will affect a set of businesses that have until now been mostly spared from growing VAT/GST challenges. Online retailers and freight carriers will soon find themselves in the scope of foreign tax authorities. These taxpayers will need to undertake the same iterative process as their digital services counterparts and will face the same compliance requirements.

Future Challenges: Emerging Technologies

Companies should also prepare for the challenges that cutting-edge technological developments (for example, digital currencies and 3-D printing) and disruptive business models (for example, crowdfunding and crowdsourcing) are beginning to pose within the VAT/GST world.

For several years, well-known commercial retail organizations have been accepting digital currency[42] as payment for goods and services. These digital currencies have not received much attention from most tax authorities, and their tax treatment is not clear. Should they be treated as regular currencies and legal tender? Should a business mining (that is, creating) and selling digital currency charge VAT/GST on the value of the digital currency sold? If digital currency is not legal tender, should it be considered a voucher? Could it be a type of digital good itself that would create a barter transaction? Some jurisdictions have begun to provide guidance on a few of these questions.

In October 2015 the Court of Justice of the European Union issued its first ruling[43] on the digital currency known as bitcoin, holding that transactions involving the buying and selling of bitcoins are exempt from VAT under the provision concerning transactions relating to "currency, bank notes and coins used as legal tender." Japan

[36] *See* Australian government, Department of Immigration and Border Protection, "Low-Value Import Threshold Taskforce" (2012). *See also* Mattes, *supra* note 3.

[37] Treasury Laws Amendment (GST Low Value Goods) Bill 2017 (Australia).

[38] Proposal for a council directive amending Directive 2006/112/EC and Directive 2009/132/EC regarding VAT obligations for supplies of services and distance sales of goods, COM(2016) 757 (Dec. 1, 2016).

[39] HMRC, "VAT Guidance: Overseas Business Using Online Marketplace to Sell Goods in the U.K." (2017).

[40] "Russian Legislation Being Drafted to Impose VAT on Foreign Online Retailers," *Orbitax Daily News*, Mar. 16, 2017.

[41] The Federal Council (Switzerland), "Federal Council Brings Revised Value Added Tax Act Into Force" (June 2, 2017).

[42] Bitcoin is the most famous example. *See also* Aleksandra Bal, "Stateless Virtual Money in the Tax System," 53(7) *Eur. Tax'n* 351 (July 2013).

[43] *See* CJEU, "The Exchange of Traditional Currencies for Units of the 'Bitcoin' Virtual Currency Is Exempt From VAT," Release 128/15 (Oct. 22, 2015) (discussing judgment in *Skatteverket (Sweden) v. David Hedqvist*, C-264/14 (CJEU 2015)).

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passed the 2017 tax reform bills that include amendments, effective July 1, exempting the sale of virtual currency from consumption tax.[44] Australia's latest budget proposed treating digital currencies as money, reversing the Australian Tax Office's practice of taxing transactions involving digital currencies.[45] If adopted, the measure would be retroactively effective from July 1, 2017.

However, the answers to questions regarding digital currency are, in most cases, unclear and speculative given the general absence of specific legislation, official guidance, and case law.[46]

Another challenge for businesses involves 3-D printing. This may turn the manufacturing and distribution industries upside down and revolutionize long-standing business models. In the not-too-distant future, every person with a 3-D printer at home will be capable of making physical goods from a digital file downloaded from the internet. A VAT/GST is a tax on the value added by each actor in a supply chain, and the existing system is largely premised on the notion that full value is delivered to the consumer. However, 3-D printing may disrupt the traditional supply chain by moving manufacturing activities from factories to the consumer's printer. As a result, much of the taxable value added may migrate to the end of the supply chain, thus increasing the number of potential "manufacturers." Government and businesses face new issues, including: How will the VAT/GST be imposed? Who will be liable to collect the tax? Who will effectively bear it? Will the owner of the printer be considered a "business" or a "final consumer"?

Crowdfunding is another innovation that will exponentially increase the VAT/GST challenges for many companies. Crowdfunding refers to raising funds for a specific project via an open call on the internet, typically using specially designed platforms that allow for peer-to-peer interaction between entrepreneurs and financial contributors. Crowdfunding platforms generally receive a fixed portion of the contributions made. There usually is a limited funding period and small contributions from a large number of parties are common. The two main crowdfunding models are nonfinancial return models, in which the return to the contributor may range from nothing (in other words, the contribution is a donation) to goods or services (a reward-based model); and financial return models, in which a monetary return is expected, such as participation in revenues or securities (crowd investing) or interest on loans (crowd lending).[47]

In 2015 the European Commission began examining the VAT implications of crowdfunding.[48] In its working paper, the commission:

- considered whether a reward constitutes a sale of goods or services for VAT purposes;
- considered whether the contribution should be considered a payment on account before the goods or services are provided;
- considered what the taxable base should be on the sale of goods or services; and
- suggested potential VAT treatments for rewards of a symbolic value.

Concerning financial return models, the main questions are what the VAT treatment should be for the following situations:

- when crowd investing results in a participation in future earnings;
- when crowd investing is an investment in securities;
- when crowd lending is employed; and
- when intermediary services are provided by crowdfunding platforms.

While most jurisdictions have not issued guidance on this topic, the Australian Taxation Office has held that the donation-based model is not subject to GST, the reward-based model is subject to GST, and both the equity- and debt-based models are akin to GST-exempt financial transactions.[49]

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[44] *See* KPMG, "Japan e-Tax News No. 131" (Mar. 28, 2017).

[45] Mary Swire, "Numerous GST Changes Confirmed in Australian Budget," Tax-News.com (May 11, 2017).

[46] *See* Machiel Lambooij, "Retailers Directly Accepting Bitcoins: Tricky Tax Issues?" 3 *IBFD Derivatives & Financial Instruments* (May/June 2014).

[47] European Commission, VAT Committee, "Question Concerning the Application of EU VAT Provisions," Working Paper No. 836 (Feb. 6, 2015).

[48] *Id.*

[49] Australian Taxation Office, "GST and Crowdfunding" (Jan. 3, 2017).

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Similar challenges are posed by crowdsourcing (that is, obtaining services, ideas, or content by soliciting contributions from a large group of people, especially from an online community rather than from traditional employees or suppliers), a popular practice among businesses worldwide. Several tax authorities have issued guidance, especially regarding ride-sharing services, to clarify the VAT/GST responsibilities of the parties involved. For example, guidance from the Australian Taxation Office provides that drivers of ride-sharing services may be providing taxable travel services for GST purposes and may thus be required to register for GST purposes and issue tax invoices upon the passenger's request.[50] Moreover, Canada recently amended the definition of a taxi businesses in the Excise Tax Act, causing, effective July 1, 2017, the drivers of ride-sharing services to incur the same GST responsibilities as taxi drivers and thus be liable to register for and collect GST on their services.[51]

Conclusion

We have highlighted the potential VAT/GST challenges that technological changes and improvements have created in recent years. As long as a business goes through a step-by-step analysis and is capable of answering the basic questions governing VAT/GST (who, what, where, when, and how much), it should be able to identify its global VAT/GST footprint and related compliance obligations, regardless of how business models and laws evolve.

While new technologies may create challenges for the effective taxation of consumption, they may also be the key to reducing the administrative and compliance cost of taxation. New technologies are also being used by governments to increase VAT/GST compliance and reduce VAT fraud. We have observed the spread of e-invoicing and electronic reporting. Real-time reporting is a reality in a few jurisdictions. Audits are increasingly performed using data and analytics tools. In the future, it may well be that VAT/GST compliance will be simplified by systems allowing a direct, secure interchange between businesses and authorities, obviating the need for issuing invoices, filing returns, and perhaps even undergoing audits. ■

[50] *See, e.g.*, Australian Taxation Office, "Providing Taxi Travel Services Through Ride-Sourcing and Your Tax Obligations" (May 17, 2017).

[51] *See, e.g.*, Canada, "Budget 2017: Chapter 4 — Tax Fairness for the Middle Class."

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