Asia-Oceania Tax Consultants Association

VAT/GST treatment of digitised services across the Asia Pacific region

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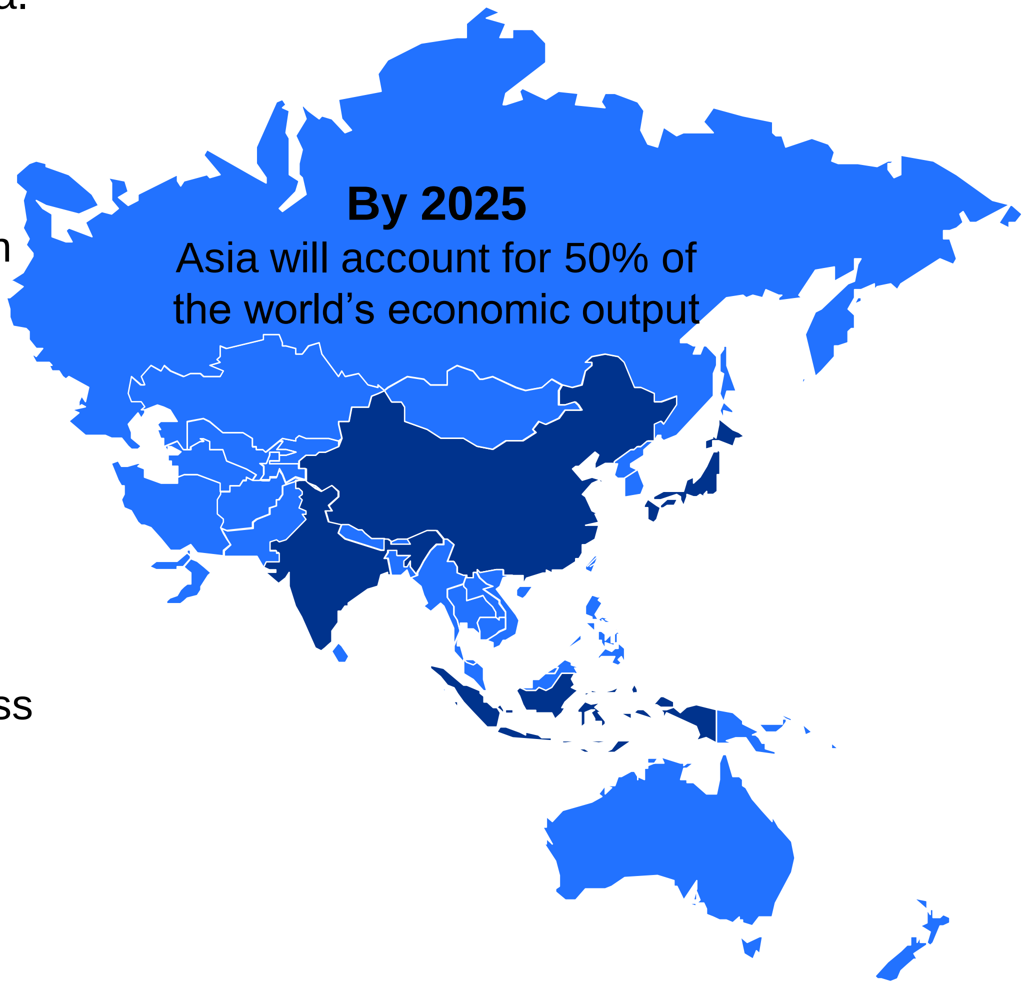
Agenda

- Country by country indirect tax position across the Asia Pacific region
- General themes and challenges identified by the OECD's Digital Economy report
- Why applying the OECD's recommendations to the Asia Pacific region is more difficult
- Some challenges for tax authorities to consider and overcome in modernising VAT systems to deal with the emergence of digitised services
- Countries on the move – Australia, China and Malaysia
- Conclusions

The Asian Century

- By 2025, 4 of the 10 largest economies in the world will be in Asia – China, India, Japan and Indonesia.
- Resulting in several important consequences for indirect tax:
  1) As economies grow and develop, domestic consumption tends to increase leading to an increase in indirect taxes
  2) MNCs are responding by entering new markets, investing in infrastructure and deploying capital, and upskilling and employing local populations, driving ↓ corporate taxes and ↑ indirect taxes
  3) The growth of e-commerce and online shopping has effectively created a borderless world, requiring countries to have efficient customs and indirect tax policies
  4) Our increasingly connected world requires taxes, or tax systems, which apply common principles across borders



Current country-by-country position across Asia Pacific

ASPAC country	Standard VAT/GST rate	Exported services (B2B)	Imported services (B2B)
Australia	10%	Zero rated	– Reverse charge where GST not fully creditable
Cambodia	10%	Zero rated	– No reverse charge and no input tax credits allowed
China	17% for most goods 6%, 11% or 17% for services subject to the VAT pilot program	Most are exempt Zero rating only applies to certain international transportation, R&D and design services	– Subject to withholding VAT, which is payable either by local agent or recipient; – Withholding VAT is creditable to domestic recipient
India	12.5% to 15% VAT for goods Service Tax at 12.36% for services	Zero rated	– Service tax payable under a reverse charge
Indonesia	10%	Limited services are zero rated	– Subject to VAT at 10%
Japan	8% CT Expected to increase to 10% from 1 October 2015	Zero rated	– Not subject to CT – Place of supply is the place the service is originated. However, destination-based taxation may be introduced in 2015.
Korea	10%	Zero rated	– Not subject to VAT, unless the service recipient uses the service for a VAT exempt business, then the recipient must collect VAT from the non-resident service provider
Malaysia	10% Sales Tax for goods 6% Service Tax for services 6% GST from 1 April 2015	Zero rated under GST	– GST payable under a reverse charge

Current country-by-country position across Asia Pacific

ASPAC country	Standard VAT/GST rate	Exported services (B2B)	Imported services (B2B)
New Zealand	15%	Zero rated	– Reverse charge where GST not fully creditable
Philippines	12%	Zero rated subject to strict conditions	– Not subject to VAT
Singapore	7%	Zero rated	– Reverse charge suspended. Businesses do not need to account for GST
Taiwan	5%	Zero rated	– Subject to VAT payable by recipient unless the service is used for education, research, or experiment – Exemption available if the buyer is a business entity who engages in VAT taxable business only and the services are used solely in the taxable business
Thailand	7%	Zero rated	– VAT payable under a reverse charge
Vietnam	5% or 10% depending on type of goods / services	Zero rated except for: (i) VAT-exempt for financial, technology transfers; outbound telecommunications & re-insurance (ii) VAT at 10% for some services to EPZs	– Generally subject to 5% VAT withholding tax – Plus 5% Corporate Income Tax under the Foreign Contractor Tax regime

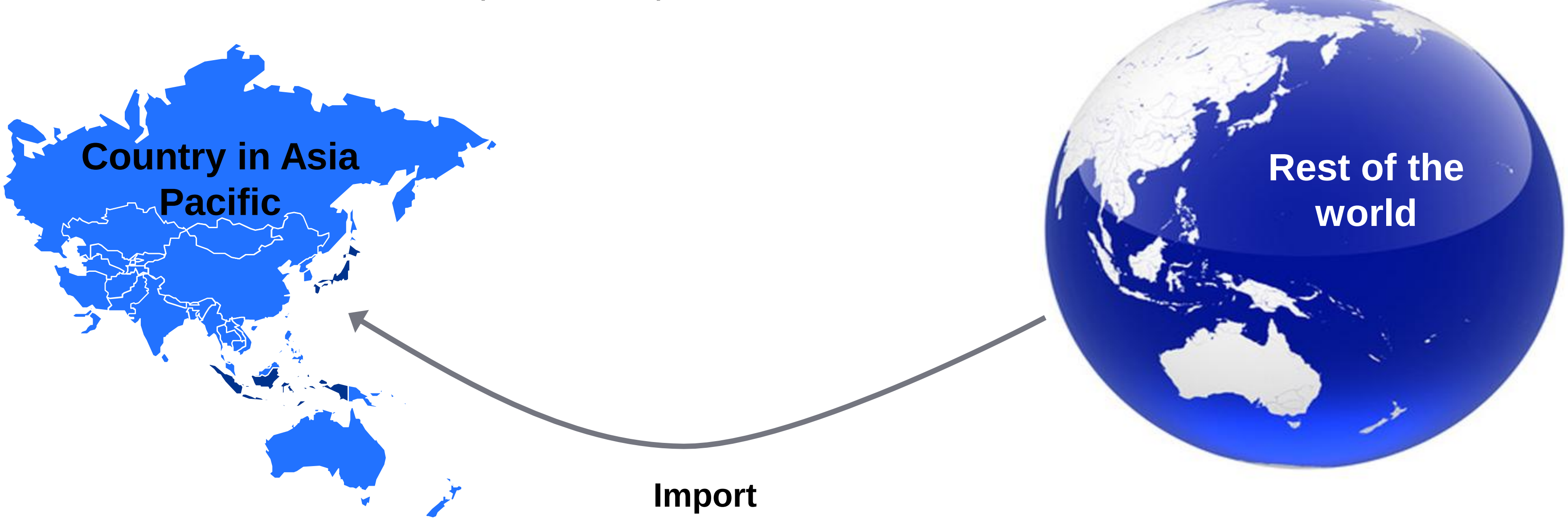
New business models of the digital economy – indirect tax issues

OECD Digital Economy Report

The digital economy – indirect tax issues

Recommendations 1 and 2 – imported digitised services from B2C; imported intangibles and services from B2B

The problem: No VAT or GST is paid on importation



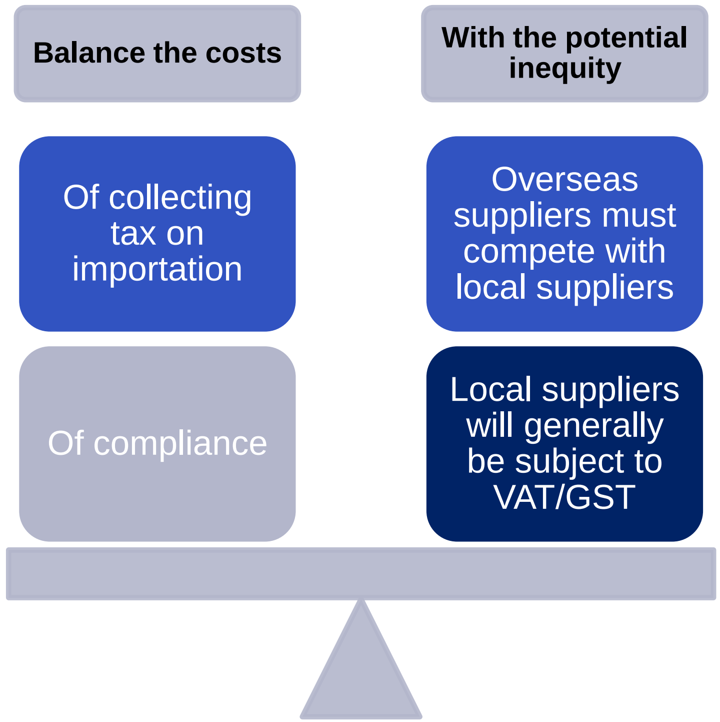
Recommendations:

- B2C: require non-resident suppliers to register for VAT/GST. No point in imposing VAT/GST collection obligations on end-consumers. Improved information exchanges, assistance with audits and recovery to enforce.
- B2B: introduce reverse charge rules

The digital economy – indirect tax issues

Recommendation 3 – low value imports of goods

The problem:



Recommendations:

- Tax authorities to significantly improve efficiency of processing imports
- Introduce simplified registration systems to enable non-residents to register for VAT/GST

The digital economy – indirect tax issues

So let's go and implement the OECD's recommendations in the Asia Pacific region

What could possibly go wrong?

The digital economy – indirect tax issues

Core Principle – countries should apply the 'destination principle'

- The destination principle means: VAT/GST is paid in the jurisdiction in which the relevant good or service is **consumed**, rather than the jurisdiction from which the relevant good or service is **supplied.** It ensures neutrality between local supplies and cross-border supplies

- VAT/GST is levied only once as follows:

  – The supplier located in country A is able to supply the good or service as a zero rated export from country A

  – The customer, located in country B, is able to receive the good or service with VAT/GST being paid in country B, either when the good is imported, or when the service is provided

- Many countries in Asia Pacific do not currently apply the destination principle properly. Possible challenges:

  – Double taxation
  – Potentially no VAT/GST being paid

Challenges of implementing the OECDs Digital Economy Report in the Asia Pacific region

No reverse charge rules

- A number of Asia Pacific countries do not have a reverse charge:
  - Cambodia
  - Japan
  - Philippines
  - Singapore (currently suspended)
- Both China and Vietnam operate a ‘VAT withholding system’ which is substantially similar in effect to a reverse charge
- Implementation of the OECD’s recommendations will require reverse charge systems to be introduced into many of these countries to deal with cross-border B2B supplies
- If introduced, there may be high levels of non-compliance
- Lower VAT/GST rates in Asia Pacific means the competitive advantage in sourcing services from offshore is lesser – perhaps one reason why a reverse charge isn’t as common?

Challenges of implementing the OECDs Digital Economy Report in the Asia Pacific region

Scope of VAT/GST needs to broadened

- VAT/GST rules in Asia Pacific need to be modernized to cater for the digital economy
- “Electronically supplied services” definition in the United Kingdom is a useful benchmark
- China and Australia do not have specific rules to cope with electronically supplied services
- To ensure the OECDs principles are properly implemented, countries in the Asia Pacific region need to:
  - consider introducing into their domestic legislation a concept similar to that of “electronically supplied services”; and
  - to facilitate foreign providers registering, collecting and remitting VAT/GST efficiently

Challenges of implementing the OECDs Digital Economy Report in the Asia Pacific region

Currency controls

- What is the practical implications of applying the destination principle in countries which operate currency controls?
- Currency controls make it extremely difficult for a non-resident supplier operating in the digital economy to market and sell their services to consumers in those countries with currency controls
- China, Vietnam, India and Thailand operate currency controls (to varying degrees)
- Currency controls impact the collection of VAT/GST

Challenges of implementing the OECDs Digital Economy Report in the Asia Pacific region

No European Union style one-stop shop

- The European Union (EU) will be implementing a number of changes to the VAT treatment of radio, broadcasting and electronically supplied services from 1 January 2015
- The destination principle will be adopted - VAT will be charged in the place where the customer belongs (if the customer is located within the EU), and VAT will not apply when EU suppliers sell to customers outside the EU
- An administrative measure is being introduced to facilitate compliance through the adoption of a 'one-stop shop' where suppliers lodge 1 VAT return for all 28 EU member states
- Could something similar apply in Asia Pacific, or even in ASEAN countries? Would it work? How do you do it when there is nothing similar to the EU?
- If not, suppliers would need to account for VAT/GST all over the world, potentially in over 150 countries = inefficient

Challenges of implementing the OECDs Digital Economy Report in the Asia Pacific region

No zero rating for exported services

- To alleviate double taxation the supplier's jurisdiction needs to zero rate the exported good or service

- A number of countries in Asia Pacific impose restrictions on this either by:

  - Imposing VAT/GST on exported services;
  - Narrowing the scope of zero rating for exported services, or imposing significant compliance or administration costs;
  - Exempting rather than zero rating exported services, resulting in the supplier bearing VAT/GST on their inputs; or
  - Not providing for full refunds of excess input VAT/GST credits for exported goods or services

- China and Indonesia impose limitations on the zero rating of exported goods and services

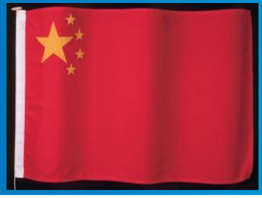
- A number of countries in Asia Pacific preclude foreign businesses from registering for VAT/GST and/or preclude refunds of excess input credits

Countries on the move - Australia

Issues in Australia:

- The low value importation threshold ($A1,000) is considered to be too high by international standards; leads to a perception that foreign businesses can compete more effectively than domestic businesses – that perception is diminishing as a result of currency changes. Likely to be addressed in the near future
- The definition of whether a supply by a non-resident is subject to Australian GST on B2C transactions is too vague and not fit for purpose – the terminology used is whether “the thing is done in Australia”. Need to introduce a broader concept similar to “electronically supplied services”
- The process for non-residents registering for Australian GST can be too difficult – process is partly made more difficult because of concerns about refund fraud – need to make it easier when non-resident is in a GST payable position
- B2B transactions already captured by reverse charge rule where the recipient is ineligible for a full input tax credit – problem is more in compliance than with the rules

Countries on the move - China



Recent developments at a glance:

- VAT has applied for many years to the sale and importation of goods into China, typically at a 17% VAT rate
- VAT is being expanded to the services sector progressively from 2012-2015, with new VAT rates of 6% and 11% also being used

Likely issues to arise in the digital economy:

- Most exported services are exempt from VAT, not zero rated. This leads to a denial of some related input tax credits
- Exported goods are “zero rated” but there are different categories of VAT refund rates applicable, so in substance, many exports bear some or all related input VAT cost
- There is generally no ability to claim refunds of excess VAT credits in China (zero rated exports is the only exception). Refunds of excess VAT credits may be carried forward to offset future output VAT (with no time limit)
- Registration for VAT purposes is not generally permissible for foreign entities. This means that foreign suppliers of digitised services cannot properly account for the VAT
- Imported services are subject to VAT withholding, not a reverse charge. VAT withholding affects the commercial and accounting treatment (often adversely for the foreign supplier), whereas reverse charge does not

Countries on the move - Malaysia

The new GST system at a glance:

- 6% GST rate which applies from 1 April 2015
- Exported services are zero rated
- Imported B2B services are subject to reverse charge

Likely issues to arise in the digital economy:

- Reverse charge rule applies to all imported B2B services, even if recipient is eligible for a full input tax credit – does this balance compliance costs with tax risk appropriately?
- Reverse charge applies to any business acquiring services from offshore, even if registered for GST or not. This means that unregistered businesses (e.g. those below registration threshold) need to complete a GST declaration form and pay output tax – does this balance compliance costs with tax risk appropriately?
- Foreign suppliers of digitized services selling B2C would ordinarily not be required to register for GST purposes in Malaysia and therefore no GST liability would ordinarily arise

Conclusions

- Indirect taxes have an important role to play in ensuring that businesses providing goods and services in the digital economy across borders pay their ‘fair share’ of tax
- Work needs to be done to turn the OECDs Digital Economy Report into real practical outcomes in the Asia Pacific region – the EU model cannot simply be replicated here, without substantial change
- The following all place significant obstacles in the path of a more equitable outcome:

Problems of double taxation is likely to arise in practice

Excessive compliance costs in having to register, collect and remit indirect taxes across each separate jurisdiction in the Asia Pacific region

The need to modernize indirect tax systems to deal with the digital economy

An absence of reverse charge rules

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cutting through complexity

Thank you!