Commonwealth of Puerto Rico

Tax Reform Assessment Project

Unified Tax Code of Puerto Rico:

Tax Policy Implementation Options

Appendix

October 31, 2014

Table of Contents

Appendix A: Individual Tax Expenditures 1
Appendix B: Business Tax Expenditures 10
Appendix C: Options for Goods and Services Tax 20
Appendix D: Goods and Services Tax Special Cases 109
Appendix E: Goods and Services Tax Exemptions 141

KPMG's role is limited to the services and deliverables articulated in the Contract for Professional Services dated March 18, 2014 as subsequently amended (the "Engagement Contract"). It is understood that any actions taken by the Government of the Commonwealth of Puerto Rico related to these services and deliverables may involve numerous factors that are outside of the Contract's scope. KPMG's services and deliverables cannot take such factors into account and, therefore, recommendations for such actions are not implied and should not be inferred from these services and deliverables. Further, while such deliverables may include analyses of certain legislative initiatives, no service described in the Engagement Contract and/or subsequent amendments will involve advising the Department regarding lobbying or other public policy advocacy activities related to legislation or regulation, including evaluating the likelihood of enactment of any proposed initiative or providing advice to the Department as to methodologies to ensure enactment. KPMG cannot undertake any role in connection with the Contract services that could be deemed lobbying, public policy advocacy, or impair the independence of KPMG as an auditor for the Department of the Treasury such as drafting legislation and engaging in implementation assistance.

Appendix A: Individual Tax Expenditures

Appendix A: Estimates of Individual Tax Expenditures

This document provides estimates of individual income tax revenue losses attributable to provisions of the Puerto Rico tax laws that allow an exclusion, exemption or deduction from gross income, or provide a special credit or preferential rate of tax. These estimates attempt to measure reductions in personal income tax liability stemming from tax provisions that provide tax benefits (relative to a normative income tax law) to a particular group of taxpayers. Items that provide less favorable tax treatment, which can be viewed as negative tax expenditures, are excluded from these estimates.

The estimates contained in Table 1 below are based on (1) actual income tax returns of 1,053,703 taxpayers who filed tax returns (Form 481.0 or Form 482.0) for the 2012 calendar year and (2) the most current tax rate schedule.

The magnitude of a tax expenditure is the difference between tax liability under current law and the tax liability that would result in the absence of the tax benefits of a particular provision (e.g., exclusion from measure of gross income). The estimates in Table 1 below use a methodology that serves as a proxy for re-computation of each individual taxpayer's tax liability in the absence of a given provision. It does not consider the effect of a provision on the computation of the alternative minimum tax, its effect on possible credit limitations, or any other indirect effects on tax liability.

Additionally, the estimates assume no change in taxpayer behavior in response to changes to the current tax regime. For example, while eliminating a deduction to one type of business activity may induce taxpayers to engage in such activity less frequently (thereby making the tax expenditure estimate an overestimation), the estimates below assume no such reduction in the activity generating the deduction.

Estimation Methodology

Tax Expenditure Estimates Related to Credits

Since credits provide a dollar for dollar reduction in tax liability, tax expenditure was estimated simply as the aggregate of all credits claimed by all taxpayers on Form 481.0, Part 1, Line 13, Form 482.0, Part 3, Line 23, or Form 482.0, Schedule B, Part II.

Tax Expenditure Estimates Related to Items Excluded or Exempted from the Measure of Gross Income

Tax expenditures on excluded and exempted items were each estimated using the same methodology. The excluded or exempted amount reported on Schedule IE of the taxpayer's return was added to net taxable income reported on the return to arrive at a modified taxable income measure. Based on the taxpayer's modified taxable income, a marginal tax rate was assigned to the taxpayer using the 2013 tax rate schedule. The tax expenditure was thereafter estimated to be the amount claimed, multiplied by the marginal tax rate calculated.

Tax Expenditure Estimates Related to Deductions from Gross Income

The deduction reported on Schedule A of the taxpayer's return was added to net taxable income reported on the return to arrive at a modified taxable income measure. Based on the taxpayer's modified taxable income, a marginal tax rate was assigned to the taxpayer using the 2013 tax rate schedule. The tax expenditure was thereafter estimated to be the amount of the deduction, multiplied by the marginal tax rate calculated.

Tax Expenditure Estimates Related to Preferential Rate Items

The measure of income taxed at specified rates reported on Schedule A2 Individual of the taxpayer's return was added to Net Taxable Income at regular rates (Line 10, Column A of Schedule A2) to arrive at modified net taxable income taxable at regular rates. Based on this modified net taxable income measure, a marginal tax rate was assigned to the taxpayer using the 2013 tax rate schedule. The tax expenditure was thereafter estimated to be the amount claimed, multiplied by the marginal tax rate minus the preferential rate.

Table 1: Individual Income Tax Expenditure Table

Items in red could be repealed

Items in blue could be modified

Item	Expenditure	Percent of Tax Benefit Enjoyed By Taxpayers Taxed At Highest Marginal Tax Rate	Number of Claimants
Exclusion of employment provided health insurance	No Data		
Individually purchased health insurance	No Data		
Basis step-up at death	No Data		
Like-kind exchanges	No Data		
CREDITS			
Credit for investment in film industry development	$798,838	98.1%	10
Credit attributable to losses or for investment in Capital Investment	$19,224	N/A	4

Fund, Tourism or other funds, or direct investments			
Credit for payments of Membership Certificates by Ordinary and Extraordinary Members of Employees-Owned Special	$419	35.8%	3
Credit for the purchase of tax credits	$76,388,886	98.11%	405
Credit for investment in housing infrastructure	$287,071	93.61%	7
Credit for investment in the construction or rehabilitation of rental housing projects for low or moderate income families	$85,000	100.00%	2
Credit for construction investment in urban centers	$3,690,201	90.98%	32
Credit for merchants affected by urban centers revitalization	$373,636	100.00%	9
Credit to investors who acquire an exempt business that is in the process of closing its operations in Puerto Rico	$14,183	65.95%	6
Credit for purchases of products manufactured in Puerto Rico and Puerto Rican agricultural products	$0	N/A	N/A
Credit for contributions to Santa Catalina's Palace Patronage	$77,000	100.00%	1
Credit for the establishment of an eligible conservation easement or donation of eligible land	$0	N/A	N/A
Exemption for persons that operate as bookseller	$117,095	99.82%	2
Credit for investment Act 73-2008	$1,224,956	99.80%	8

Credit for investment Act 83-2010	$398,270	98.43%	8
Credit for alternate basic tax from previous taxable years	$2,300,671	95.69%	108
Credits carried from previous years	$14,015,046	57.58%	155
Other credits not included on the preceding lines	$5,202,666	92.86%	252
DEDUCTIONS			
Allowable deduction for mortgage interest	$278,554,515	62.50%	239,845
Casualty loss on your principal residence	See Note 1	N/A	N/A
Medical expenses	$6,987,818	42.52%	17,731
Charitable contributions	$22,588,652	73.30%	56,197
Loss of personal property as a result of certain casualties	$544,369	29.21%	1,968
Contributions to governmental pension or retirement systems	$56,428,128	36.72%	173,071
Total contributions to individual retirement accounts	$18,906,891	84.58%	17,774
Total contributions to health savings accounts with a high annual deductible medical plan	$12,107	69.92%	227
Educational Contribution Account	$797,485	89.60%	3,674
Total interest paid on students loans	$6,350,331	63.08%	26,542
EXCLUSIONS FROM INCOME			
Compensation for injuries or sickness	$6,930,160	60.03%	1,785
Benefits from federal social security for old-age and survivors	$130,731,918	31.79%	60,126

Income derived from discharge of debts	$1,501,713	75.82%	308
IVU Loto prizes	$207,292	86.34%	44
Meal and travel expenses paid to Certain Volunteers up to $1,500 under Act 261-2004	$17,906	36.80%	46
Other exclusions	$4,729,903	60.33%	1,753
EXEMPTIONS FROM INCOME			
Fringe benefits paid by the employer in relation to a cafeteria plan	$209,035	43.85%	263
Obligations from the United States Government, any of its states, territories or political subdivisions	$7,400,575	93.44%	986
Obligations from the Government of Puerto Rico	$39,155,077	95.49%	2,126
Securities under Agricultural Loans Act	$873,445	82.36%	379
Certain Mortgages	$8,910,858	89.22%	1,642
Obligations secured or guaranteed under the Servicemen's Readjustment Act of 1944	$79,619	82.21%	25
Securities issued by cooperative associations up to $5,000	$78,694	79.08%	248
Deposits in Puerto Rico interest bearing accounts up to $2,000 ($4,000 for married filing jointly)	$4,467,606	66.73%	24,214
Obligations issued by the Conservation Trust, Housing and Human Development Trust and San Juan Monuments Patronage	$147	0.00%	2
Limited dividends corporations	$1,893,505	85.97%	855

Cooperative associations	$1,485,144	74.12%	3,131
International Insurer or Holding Company of the International Insurer	$217,517	86.30%	168
Expenses of priests or ministers	$150,117	19.92%	117
Recapture of bad debts, prior taxes, surcharges and other items	$10,592	0.00%	7
Stipends received by certain physicians during the internship period	$2,710,003	43.79%	495
Prizes from the Lottery of Puerto Rico and the Additional Lottery	$4,852,671	92.90%	401
Income from pensions or annuities, up to the applicable limitation	$137,388,225	18.46%	84,027
Christmas Bonus, Summer Bonus and Medicine Bonus	$127,086	28.41%	2,166
Gain from the sale or exchange of principal residence by certain individuals	$8,674,939	87.08%	642
Certain income related to the operation of an employee's owned special corporation	$31,519	26.43%	34
Cost of living allowance (COLA)	$6,633,382	70.60%	6,646
Unemployment compensation	$701,893	45.13%	2,249
Compensation received from active military service in a combat zone	$960,610	33.16%	291
Income received or earned in relation to the celebration of sports games organized by international associations	$7,098	0.03%	10
Compensation received by an eligible investigator or scientist	$755,946	94.54%	57

Compensation received by an eligible investigator or scientist in the District under Act 214-2004	$152,969	91.74%	20
Rents from the Historic Zone	$773,172	76.32%	101
Compensation to citizens and aliens nonresidents of Puerto Rico for the production of film projects	$60,950	99.84%	6
Remuneration received by employees of foreign governments or international organizations	$465,765	95.59%	29
Income from buildings rented to the Government of Puerto Rico for public hospitals, health or convalescent homes	$2,842,883	70.64%	1,439
Income derived by the taxpayer from the resale of personal property or services which acquisition was subject to tax	$127,160	67.55%	17
Accumulated Gain in Nonqualified Options	$1,113,573	86.58%	97
Distributions of Amounts Previously Notified as Deemed Eligible Distributions under Section 1023.06	$7,028,034	98.68%	50
Distributions from Non Deductible Individual Retirement Accounts	$2,698,698	85.02%	274
Special Compensation Paid due to a Liquidation or Close of Businesses under Article 10 of Act No. 80 of May 30, 1976	$24,573,971	89.10%	1,167
Distributions of Dividends or in Liquidation from Exempt Businesses	$30,205,021	99.24%	91
Salaries from Overtime during Emergency Situations	$1,259,858	76.90%	576

Income from copyrights up to $10,000 under Act 516-2004	$38,424	72.92%	27
Income received by designers and translators up to $6,000 under Act 516-2004	$7,378	10.85%	17
Distributable share on exempt income from flow-through entities	$19,489,785	99.01%	116
Other exemptions	$37,934,015	83.38%	5,892
PREFERENTIAL RATE ITEMS			
Net Long Term Capital Gain at 10%	$66,304,818	99.51%	2,562
Eligible Distribution of Dividends at 10%	$40,874,647	98.5405%	6,163
Distributions from Qualified Retirement Plans at 20%	$3,797,274	105.7357%	935
Distributions from Qualified Retirement Plans at 10%	$3,196,794	93.9605%	592
Interest on Deposits from Financial Institutions at 10%	$3,260,447	96.2749%	1,210

Note 1: There appear to have been data entry issues related to this particular deduction on the Short Form. The entries are duplicates of the charitable contributions deductions according to the data provided by personnel at the Commonwealth's Treasury Department.

Appendix B: Business Tax Expenditures

Appendix B: Business Tax Expenditures

Item	Total Expenditure	Regular Corporations	Exempt Corps And Other Business Entities	Number of Claimants
ACT 8 OF 1987 INCENTIVES				
Total reduction				
Special Deduction-Payroll	$140,193		$140,193	10
Special Deduction- HR Training	$0		$0	0
Special Deduction-R&D Expense	$0		$0	0
Special Deduction-Investment on buildings, structure, M&E	$345,492		$345,492	2
ACT 135-1997				
Total reduction				
Special Deduction-Payroll	$9,755,962		$9,755,962	127
Special Deduction- HR Training	$1,296,309		$1,296,309	21
Special Deduction-R&D Expense	$8,596,386		$8,596,386	5
Special Deduction-Investment on buildings, structure, M&E	$102,981,067		$102,981,067	88
Special credits granted	$3,348,016		$3,348,016	4
Credit for products manufactured in Puerto Rico	$1,946,366		$1,946,366	17
Credit for losses of United States parent company	$842		$842	1
Credit for taxes withheld on royalty payments	$13,300,000		$13,300,000	1
Credit for donation of an eligible conservation	$0		$0	0

easement or donation of eligible land				
Credit for construction investment in urban centers	$5,581,202		$5,581,202	1
Credit for merchants affected by urban centers revitalization	$0		$0	0
Credit for purchases of products manufactured in Puerto Rico	$40,546,667		$40,546,667	54
Credit for investment in research and development	$6,979,314		$6,979,314	8
Credit for investment in machinery and equipment	$0		$0	0
Credit to reduce the cost of electric power	$23,730,060		$23,730,060	100
Credit for investment in strategic projects	$0		$0	0
Credit for industrial investment	$0		$0	0
Credit for acquisition or manufacture and installation of electrical solar equipment	$16,836		$16,836	2
Other applicable credits	$18,376,813		$18,376,813	17
ACT 20-2012				
Total reduction				
ACT 73-2008				
Total reduction				
Special Deductions	$10,170,000		$10,170,000	3
Credit for purchases of products manufactured in Puerto Rico	$1,318,456		$1,318,456	3
Credit for job creation	$0		$0	0
Credit for investment in research and development	$1,998,523		$1,998,523	1
Credit for investment in machinery and equipment	$0		$0	0

Credit to reduce the cost of electric power	$467,639		$467,639	5
Credit for intellectual property transfer	$0		$0	0
Credit for investment in strategic projects	$0		$0	0
Credit for industrial investment	$23,916		$23,916	1
Credit for donation of an eligible conservation easement or donation of eligible land	$7,993		$7,993	1
Credit for construction investment in urban centers	$0		$0	0
Credit for merchants affected by urban centers revitalization	$0		$0	0
Credit for acquisition or manufacture and installation of electrical solar equipment	$0		$0	0
Other applicable credits	$0		$0	0
ACT 83-2010				
Total reduction				
Credit for purchases of products manufactured in Puerto Rico	$0		$0	0
Credit for job creation	$0		$0	0
Credit for investment in research and development	$0		$0	0
Credit for the transfer of intellectual property	$0		$0	0
Credit for donation of an eligible conservation easement or donation of eligible land	$0		$0	0
Credit for construction investment in urban centers	$0		$0	0
Other applicable credits	$0		$0	0
ACT 27-2010				

Total reduction				
SCHEDULE L PARTIALLY EXEMPT INCOME				
Total reduction				
CREDITS				
Credit for increase in investment	$111,642	$71,913	$39,729	5
Credit attributable to losses or for investment in Capital Investment, Tourism or other funds	$2,526,277	$1,781,611	$744,666	4
Credit for investment on Film Industry Development	$286,568	$286,568	N/A	12
Credit for investment in Housing Infrastructure	$570,690	$570,690	N/A	4
Credit for investment in the Construction or Rehabilitation of Rental Housing Projects for Low or Moderate Income Families	$23,603	$23,603	N/A	1
Credit to investors in an exempt business that is in the process of closing its operations in Puerto Rico	$2,939	$2,939	N/A	2
Credit for purchases of products manufactured in Puerto Rico and Puerto Rican agricultural products	$2,917,510	$2,820,683	$96,827	16
Credit for contributions to Santa Catalina's Palace Patronage	$9,793	$9,793	N/A	1
Credit for the establishment of an eligible conservation easement or donation of eligible land	$0	$0	$0	0
Credit for construction investment in urban centers	$1,825,534	$982,521	$843013	4
Credit for merchants affected by urban centers revitalization	$10,518	$10,518	$0	2
Exemption for persons that operate as publisher	$3,649	$3,649	N/A	2

Exemption for persons that operate as printer	$0	$0	N/A	0
Exemption for persons that operate as bookseller	$533	$533	N/A	1
Credit for investment Act 73-2008	$725,743	$725,743	N/A	5
Credit for investment Act 83-2010	$140,229	$140,229	N/A	1
Credit for the 2006 Extraordinary Tax	$2,790,484	$1,289,278	$1,501,206	44
Credit for additional tax on gross income paid in case of financial business	N/A	N/A	N/A	
Other credits not included on the preceding lines	$7,028,757	$6,684,245	$344,512	69
DEDUCTIONS				
Dividends received from domestic corporations	$63,562,029	$63,562,029		144
Accelerated depreciation		N/A		N/A
Charitable contributions	$6,325,832	$6,325,832		5,788
Contributions to pension or other qualified plans	$23,385,047	$23,385,047		895
Bad debts		N/A		N/A
EXCLUSIONS FROM INCOME				
Plantation insurance		$0		
Income derived from discharge of debts	$637,923	$637,923		9
IVU Loto prizes	$21	$21		1
Other exclusions	$321,350	$321,350		17
EXEMPTIONS FROM INCOME				
Interest earned from obligations from the United States Government, any of its states, territories or political subdivisions	$26,328,544	$26,328,544		98
Interest earned from obligations from the Commonwealth of Puerto Rico	$103,855,658	$103,855,658		221

Interest earned from securities under Agricultural Loans Act	$36,801	$36,801		5
Interest earned from certain Mortgages	$237,359	$237,359		25
Interest earned from obligations secured or guaranteed under the Servicemen's Readjustment Act of 1944	$0	$0		
Interest earned from securities issued by cooperative associations up to $5,000	$0	$0		
Interest earned from obligations issued by the Conservation Trust, Housing and Human Development Trust and San Juan Monuments Patronage	$0	$0		
Interest earned from loans granted by a commercial bank to an employees	$0	$0		
Interest earned from loans granted by a commercial bank in Puerto Rico for acquisition and payment of membership certificates in an employees owned special corporation	$0	$0		
Interest earned from loans granted by a commercial bank in Puerto Rico for the purchase or investment in preferred stocks of an employees owned special corporation	$0	$0		
Interest earned from loans for the establishment or expansion of small and medium businesses up to $250,000	$14,728	$14,728		1

Interest earned from loans for the capitalization of small and medium businesses up to $250,000	$3,066	$3,066		1
Dividends from industrial development income derived from certain interests	$16,819	$16,819		8
Dividends from limited dividends corporations	$47,972	$47,972		7
Dividends from cooperative associations	$351	$351		2
Dividends from international Insurer or Holding Company of the International Insurer	$0	$0		
Recapture of bad debts, prior taxes, surcharges and other items	$307,952	$307,952		2
Income from news agencies or unions	$0	$0		
Certain income related to the operation of an employees owned special corporation	$0	$0		
Income received or earned in relation to the celebration of sports games organized by international associations or federations	$299,146	$299,146		1
Income derived by the International Insurer or Holding Company of the International Insurer	$1,267,051	$1,267,051		1
Rents from the Historic Zone	$521,618	$521,618		12
Income from International Banking Entities	$31,132,576	$31,132,576		7
Income from vessels owners associations and mutual protection and indemnity	$0	$0		
Income from buildings rented to the Commonwealth of	$27,836	$27,836		3

Puerto Rico for public hospitals or schools, or health homes				
Income derived by the taxpayer from the resale of personal property or services which acquisition was subject to tax under Section 3070.01 or Section 2101 of the Internal Revenue Code of 1994	$0	$0		
Distributions of Amounts Previously Notified as Deemed Eligible Distributions under Section 1023.06(j)	$0	$0		
Distributions of Dividends and Benefits from Industrial Development Income of Exempt Businesses and in Liquidation under Act 73-2008 and Act 135-1997	$1,395,789	$1,395,789		2
Rent of residential property under Act 132-2010	$437,841	$437,841		45
Other exemptions	$17,261,128	$17,261,128		88
PREFERENTIAL RATE ITEMS				
Preferential treatment of capital gains	$8,139,392	$8,139,392		168
Interest subject to preferential rate	$195,224	$195,224		5
Other income subject to preferential rate	$420,844	$420,844		6
Income subject to preferential rates from partnerships and special partnerships		N/A		
Income subject to the 4% tax rate from the operations of an international financial entity that operates as a banking unit		N/A		

Note 1: There appear to have been data entry issues related to this particular deduction on the Short Form. The entries are duplicates of the charitable contributions deductions according to the data provided by personnel at the Commonwealth's Treasury Department.

Appendix C: Options for Goods and Services Tax

Appendix C: Goods and Services Tax

a. General Description of a Goods and Services Tax

This document outlines the form a Goods and Services Tax ("GST") in Puerto Rico could take.

This first section sets out how a GST generally operates. It is introduces and defines key GST concepts and terminology that is used in the following sections.

The second section sets out how the main operating provisions of the GST law could be structured.

The third section examines how each of the main operating provisions could be drafted based on leading practices derived from four comparable jurisdictions – New Zealand, Singapore, Malaysia and Ireland. In addition to these comparable jurisdictions, the International Monetary Fund VAT Act – Commonwealth of New Vatopia was reviewed.

The document does not address special cases such as grouping related parties for registration purposes, the treatment of branches, agents, sales of going concerns, loyalty programs, vouchers, gambling, non-resident GST refunds, electronic services supplied by a non-resident, and domestic reverse charge. Special cases are addressed in Appendix D.

Further, it does not address the administrative powers of the tax authority with respect to debt collection, disputes, rulings, audits, and penalties and any rules in respect of language requirements, currency and documentation retention. These powers and rules are generally not GST specific and the existing Puerto Rico administrative provisions could be leveraged.

1.1 Operation of a GST

GST, also known as a Value Added Tax ("VAT"), is the most common general consumption tax in the world and is recognized as the most efficient consumption tax both in terms of revenue and economic neutrality. Over 150 countries and 33 of the 34 OECD countries have implemented some form of VAT where it generally accounts for one fifth of tax revenue.[1] The recognized capacity to raise revenue in a neutral and transparent manner has contributed to the spread of GST around the world.

The key features of a GST include:

- It is a tax on final consumption;
- It is not a tax on business – GST does not generally result in a cost to a business – businesses effectively act as collection agents. A credit is provided for tax incurred on business inputs;
- GST is a multi-stage, transaction based tax that is levied at each stage of the supply chain, including imports; and

[1] OECD (2012), *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administrative Issues*, OECD Publishing, p. 28.

- It is a broad based tax that applies to most goods and services.

A GST system seeks to tax the value added at each stage in the supply chain. There are a number of methods that can be used to calculate the value added at any particular stage in a supply chain and levy the tax (including the addition, subtraction and invoice-credit methods). The addition and subtraction methods are not very common (only Japan uses a certain version of subtraction method) and do not represent practical options for Puerto Rico. These methods are not discussed.

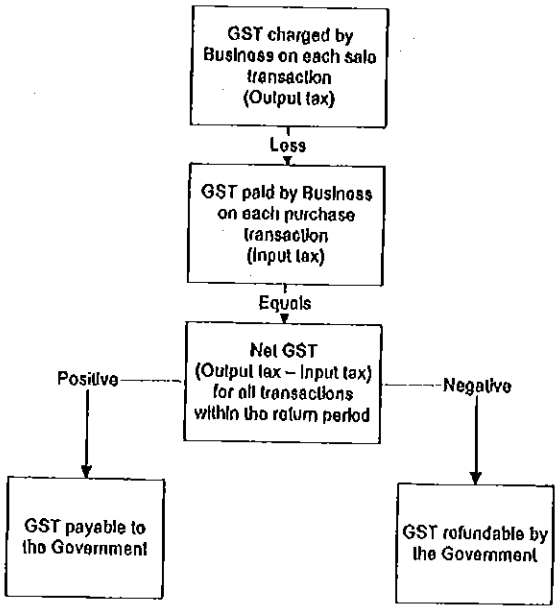
The invoice-credit method is the most common method and the only practical option if a GST is to be considered in Puerto Rico.

The OECD describes the invoice-credit method as follows:

"...each trader charges VAT at the specific rate on each sale and passes to the purchaser an invoice showing the amount of tax thus charged. The purchaser is in turn able to credit such payment of input tax against the output charged on his sales, remitting the balance to the tax authorities and receiving refunds when there are excess credits. This method is based on invoices that could, in principle, be cross-checked to pick up any overstatement of credit entitlement. By linking the tax credit on the purchaser's inputs to the tax paid by the purchaser the invoice-credit method is designed to discourage fraud."[2]

This right to deduction through the supply chain until the final consumer, where no credit is allowed, results in a business neutral tax, the burden of which lies on the final consumer (i.e., avoiding the issue of the taxation of business input that arises under an SUT).

The operation of an invoice-credit GST is illustrated as follows:

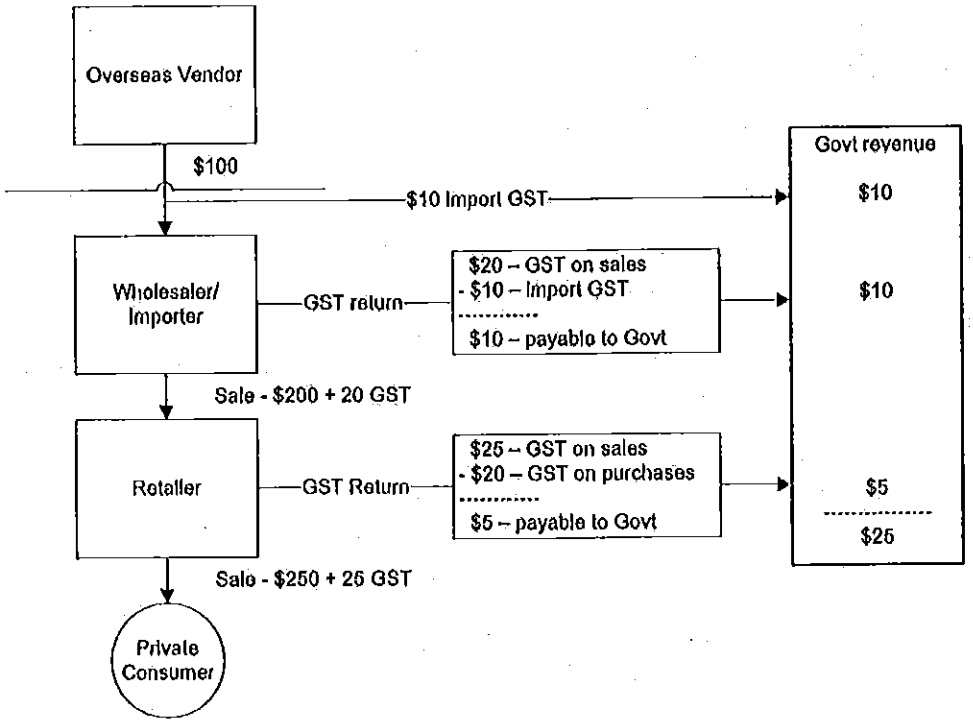


[2] OECD (2012), *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administrative Issues*, OECD Publishing, p 32.

The invoice-credit method tends to be preferred over other methods of value added taxation for the following reasons:

- The tax is levied on a transaction by transaction basis allowing the application of different rates, where required; and
- The use of an invoice for evidencing the charging of the GST and the right to deduct creates a good audit trail.

An example of the invoice-credit method applied to a supply chain is as follows (assuming a 10% GST):



Key Principles and Terminology

GST laws generally levy the tax on supplies of goods and services made in the jurisdiction for consideration in the course or furtherance of a taxable activity carried on by a taxable person.

The above statement introduces a number of GST specific terms and concepts:

- Supply;
- Consideration;
- Taxable Activity;

- Taxable Person;
- Goods and services; and
- Made in the jurisdiction.

Each of specific terms is discussed in detail in the third section of this document. However, a brief overview of each term is discussed below.

Supply – the term "supply" defines a transaction that is captured in a GST. It is often broader in concept than a "sale" to ensure that the tax captures every economic transaction, subject to limited exceptions. For example, many jurisdictions deem certain actions that would not normally be considered to be a sale as a supply for GST purposes to maintain the neutrality of the tax – e.g., goods provided free of charge to employees are deemed to be a supply for GST purposes and are subject to the tax.

Consideration – consideration generally refers to something of value that is provided in return for goods and services. However, as with the definition of supply, many jurisdictions will deem consideration to be provided in respect of certain supplies to maintain the neutrality of the tax. The example noted above of the deemed supply of goods that are provided free of charge to employees would generally require a provision deeming that the supply was for consideration in order to bring the activity within the scope of the tax.

Taxable Activity – a taxable activity is similar to the term "business" – e.g., the activity of traders, producers or service suppliers. However the term is often broader than what is traditionally thought of as a business to include such things as certain government activities. There is generally no requirement that the activity be carried on with the intention of making a profit. However, employment, hobbies and private recreational pursuits are often excluded.

Taxable Person - the term "taxable person" describes a person who is carrying on an activity that falls within the GST regime, rather than the term "taxpayer." The distinction is generally made to avoid any confusion with the person who bears the ultimate economic incidence of the tax, which is the person receiving the taxable sale.[3]

Goods and services – a supply for GST purposes will either be a supply of goods or a supply of services. The distinction between the two is important because the nature of the transaction may influence where the supply should be taxed (i.e., within Puerto Rico or outside Puerto Rico), when the supply should be accounted for, and who is liable to collect the GST.

Made in the jurisdiction – GST laws include various "place of supply" rules that help determine whether a supply is made in the jurisdiction and should be subject to the tax.

Additional principles and terms that should be noted are as follows:

Taxable supply – a supply subject to GST, whether it be it at the standard or zero rate.

Zero-rated supply – a supply subject to GST at a notional 0% (discussed in more detail below).

[3]David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996, p. 12.

Exempt supply – a supply that falls within the scope of the GST law but is exempt from the tax (discussed in more detail below).

Outside scope – a supply that falls outside the scope of the GST law and is effectively ignored for GST purposes.

Input tax – GST that is paid by the recipient of a supply.

Output tax – GST that is charged by the supplier of a supply.

Tax invoice – a formal document issued under the GST law evidencing the supply.

Accounting for the tax – generally the supplier is required to collect and remit the GST to the government. However, in certain circumstances, the recipient is required to account for the tax – e.g., where the supplier is a non-resident with no presence in the jurisdiction.

Time of supply – the time of supply refers to when the transaction should be accounted for in the GST return.

Input tax credits - Generally, GST incurred by a taxable person can be claimed as a credit if the supply that was subject to GST was acquired for the purpose of making taxable or zero-rated supplies. Where the supply was acquired for making exempt supplies, the GST cannot be claimed as a credit.

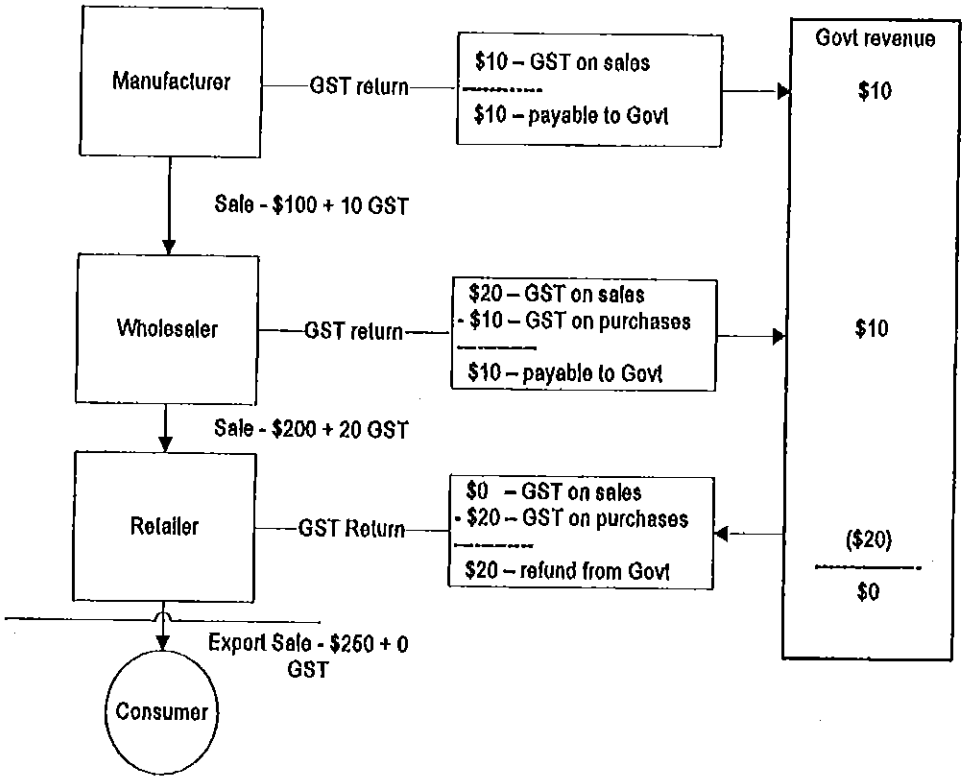
The concepts of zero-rating and exemption are extremely important and are discussed in more detail below.

Zero-rating

Where a supply of a good or service is zero-rated, no GST is charged on the sale or provision of that service. However, the person making that supply is able to recover the GST it has incurred on its purchases related to the making of that zero-rated supply (contrast this with exempt supplies below).

Zero-rating relieves the entire supply chain from tax if zero-rating is at the final stage of the chain – see diagram below.

Zero-rating is often used for exported goods and services to ensure that foreign customers do not bear the burden of domestic consumption tax.

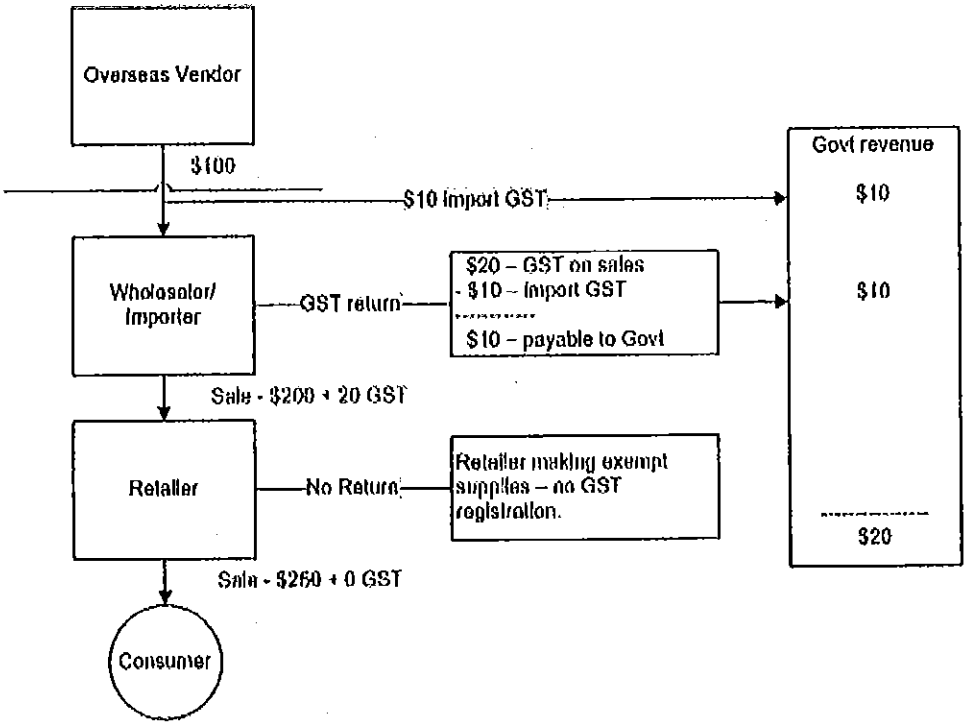


Exemption

Where a supply of a good or service is exempt from GST, no GST is charged on the sale or provision of that good or service. However, the person making that supply is unable to recover the GST it has incurred on its purchases related to the making of that exempt supply (contrast this with zero-rating above).

Exemptions are usually implemented for social reasons (e.g., healthcare and education) or because they are difficult to tax (e.g., financial services).

Exemptions have the following impact on the supply chain and the collection of the tax:



In summary, when examining the GST treatment of a supply, the following questions should be asked:

1. Is there a supply for consideration?
2. Is the supply made by a taxable person?
3. Is the supply made within the GST jurisdiction?
4. Is the supply exempt or zero-rated?
5. Who is liable to account of the tax and when?
6. Can the GST be recovered?

The following sections set out how the main operating provisions of the GST law could be structured and how each of the main operating provisions could be drafted based on leading practices.

b. Outline of Goods and Services Tax Legislation

This section sets out how a GST law could be structured in Puerto Rico. It sets out the main operating provisions of a GST. It does not set out rules for special cases, which address such things as the grouping of related parties for registration purposes and the treatment of branches, agents, sales of going concerns, loyalty programs, vouchers, gambling, non-resident GST refunds, electronic services supplied by a non-resident, and domestic reverse charge.

In addition, it does not set out the administrative powers of the tax authority with respect to debt collection, disputes, rulings, audits, and penalties and any rules in respect of language

requirements, currency and documentation retention. These powers and rules are generally not GST specific and the existing Puerto Rico administrative provisions could be leveraged.

2.A Interpretation/General Definitions

This chapter will set out the definitions of certain terms.

The following principal GST terms will be defined in separate sections:

i. "Taxable Person"

ii. "Taxable Activity"

iii. "Supply"

2.B Imposition of the Tax

i. *Imposition of the Tax*–This section will be the main charging provision of the law and will set out when GST should be charged on a supply (i.e., supplies made in Puerto Rico) and who is liable to account for the tax.

ii. *Place of supply* – This section will set out the rules for determining when a supply is deemed to be made in Puerto Rico for the purpose of the imposition of the tax.

iii. *Time of supply* – This section will set out the rules for determining when the supply is deemed to take place and the period in which the supply should be reported and GST accounted for.

iv. *Imported Services/Reverse charge* – This section will set out the rules for supplies of services made by non-residents and where the recipient of the supply should account for the tax.

v. *Value of the supply* – This section will set out the rules for determining the value of a supply upon which the GST should be charged. It will also include rules for transactions between related parties and the supply.

vi. *Imported goods* – This section will set out the rules for levying GST on the importation of goods and the interaction with the Customs rules and related relief provisions.

vii. *Value of imported goods* – This section will set out the valuation rules for goods imported into Puerto Rico, consistent with the customs rules.

viii. *Zero-rated supplies* –This section will provide the rules for zero-rating goods and services and which categories of goods and services are zero-rated.

ix. *Exempt supplies*– This section will list which categories of goods and services are GST exempt.

2.C Registration

i. *Registration* – This section will set out who is required to be registered and who can voluntarily register, including the rules in respect of calculating a taxable person's turnover for registration threshold determination, and exceptions to the registration requirement.

ii. *Cessation of requirement to be registered and cancellation of registration* – This section will set out the rules for when a taxpayer will cease being required to be registered and the cancellation of a GST registration, including notification rules and effective dates.

2.D Calculation of Tax Payable, Tax Periods, and Tax Returns

i. *Taxable periods* – This section will set out the rules for the periods the GST return must cover.

ii. *Filing of returns and payment of the tax* – This section will set out the rules for when a return must be filed and payment of any tax due should be made.

iii. *Accounting basis* – The section will set out the rules for when taxable persons are able to complete returns on a cash basis versus an accrual basis, including the conditions required to be met for each type of accounting basis.

iv. *Calculation of tax payable* – This section will set out the rules for calculating the tax payable for a particular period, including offsetting input tax against output tax.

v. *Input tax deductions/credit rules* - This section will set out the rules for determining whether an input tax credit may be claimed in respect of GST incurred on expenses by the taxable person, including deemed input tax deductions for such things as insurance payments and secondhand goods.

vi. *Adjustment and apportionment rules* - This section will set out the rules for apportioning input tax credits between taxable and non-taxable activities and where adjustments are required to be made to account for private or non-taxable use.

vii. *Bad Debts* – This section will set out the rules for recovering output tax previously accounted for on a supply but the recipient never paid for that supply.

viii. *Refund of excess tax* – This section will set out the rules relating to the payment of refunds where input tax exceeds output tax for a particular period.

ix. *Tax invoices, credit notes and debit notes* – This section will set out the rules for when a tax invoice, credit note or debit note should be issued, including the form such documents must take.

c. Goods and Services Tax Design Leading Practices

The following section sets out the leading practices for designing a GST.

The OECD International VAT/GST Guidelines describe basic neutrality principles that should apply to a GST:

- The burden of value added taxes should not lie on taxable businesses except where explicitly provided for in legislation.
- Business in similar situations carrying out similar transactions should be subject to similar levels of taxation.
- VAT rules should be framed in such a way that they are not the primary influence on business decisions.

These principles have been followed when outlining the possible structure of a GST for Puerto Rico.

In drafting these leading practices, we have reviewed four comparable jurisdictions, as follows:

- New Zealand – Goods and Services Tax Act 1985 ("NZ GST Act");
- Singapore – Goods and Services Tax Act 1993 ("Singapore GST Act");
- Malaysia - Goods and Services Tax Act 2014 ("Malaysia GST Act"); and
- Ireland - Value-Added Tax Consolidation Act 2010 ("Irish VAT Act").

In addition, we reviewed the International Monetary Fund model VAT Act – Commonwealth of New Vatopia ("IMF Model Law").

New Zealand was chosen as a comparative regime as it is widely regarded as having the gold standard of consumption tax regimes, with the following key features:

- One single rate;
- GST on goods and services and on importation;
- Limited exemptions;
- Low compliance costs for businesses and government;
- Neutrality between businesses;
- Transparency in respect of its administration.

Singapore and Ireland were chosen as they are considered competitors to Puerto Rico from a global inbound investment perspective. Further, Ireland is based on the older European model of a VAT/GST and provides a contrast against how newer consumption tax regimes have been implemented.

Malaysia was chosen as it is the most recent GST law to have been introduced.

The IMF Model Law was chosen as it has served as a guide for the implementation of a consumption tax regime in many countries and it is a broad based tax with few exemptions with a structure based on the more modern VAT/GST structures.

Below, we set out a proposed structure of a GST law and the leading practice approach for each of the relevant operational provisions.

3.A Interpretation/General Definitions

3.A.1 Taxable Person

Overview of Concept

In VAT/GST regimes the term "taxable person" is used to describe a person who is carrying on an activity that falls within the VAT/GST regime, rather than the term "taxpayer." The distinction is generally made to avoid any confusion with the person who bears the ultimate economic incidence of the tax, which is the person receiving the taxable sale.[4] This is driven from the nature of a VAT/GST being a consumption tax with the suppliers of goods and services upon which the tax is charged merely collecting that tax for and on behalf of the government.

The concept of taxable person can be compared to the concept of "merchant" used under Puerto Rico's current SUT.[5]

In a broad based GST system, the term "taxable person" generally includes all persons irrespective of their residency, establishment or incorporation. A narrow base GST system would generally define a taxable person as only those which are established or incorporated within the GST jurisdiction, for example Mexico.

Leading Practice

The definition of "Taxable person" should be drafted to include the following:

- Any person registered or required to be registered under the GST law.

The definition of "Person" should be drafted to include the following:

- A state, a local authority, board, natural person, trust, company, and partnership;
- Exclude the US Federal Government and its instrumentalities.

Discussion

The GST legislation in Singapore and Malaysia state that a person is a taxable person for GST purposes where it is required to be registered under the GST Act.[6]

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[4]David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996, ibid.
[5]PRIRC § 4010.01(h).
[6] Singapore GST Act, § 8(2); Malaysia GST Act, § 2.

The IMF Model Law also defines "taxable person" as a person who is registered or is required to register under the law.[7]

The New Zealand GST Act does not have the concept of taxable person but uses the term "registered person" for someone who is registered or required to be registered under the Act[8].

Singapore and Malaysia do not define the term "Person," however New Zealand defines person as company, an unincorporated body, a public authority and a local authority. The IMF has a similar definition that includes the state, a local authority, board, natural person, trust, company, and partnership.[9]

All the above jurisdictions utilize the term "taxable person" or "registered person" in the main charging provision to require the levying of the tax. This is generally done by requiring tax to be charged where a supply is made by the taxable or registered person within the jurisdiction, in the course or furtherance of a business or taxable activity. The imposition of GST and taxable activity are discussed under their respective sections in more detail below.

Ireland takes a slightly different and more convoluted approach, defining "taxable person" as a person who independently carries on a business.[10] This term is utilized within the main charging provision to levy the tax on any supply made by such a person. Ireland then has an additional term called an "an accountable person", which is effectively equivalent to a registered person to require the collection and returning of the tax.[11]

Leading practice would be to adopt the more certain and simple approach of New Zealand and the IMF.

Most of the comparable jurisdictions include governments and their bodies either explicitly or implicitly in the definition of "taxable person," however this is often limited to whether such public bodies are in competition with the private sector. This ensures broad based taxation and avoids any distortion arising where the private and public sector could be in competition.

Where governments and their bodies are included with the GST regime, it is often necessary to specifically include their activities within the definition of taxable activity and deem the provision of certain public goods and services to be a supply for GST purposes. We discuss these issues under "Taxable Activity" below. The issue of determining whether a public body is in competition with the private sector is also a complex issue and we discuss this under the "Taxable Activity" section below.

Given Puerto Rico is part of the United States, the constitutionality of including the federal government, state governments, and their instrumentalities should be addressed. Under the Supremacy Clause and the doctrine of sovereign immunity, the federal government and its

[7] IMF Model VAT Law, § 6.
[8] New Zealand GST Act, § 2(1).
[9] IMF Model Law, § 2.
[10] Irish VAT Act, § 2(1).
[11] Irish VAT Act, § 6.

instrumentalities are immune from state and local taxation.[12] Consequently, the federal government and its instrumentalities must be excluded from the definition of "person." While many states currently exempt state governments, their agencies, municipalities, and their political subdivisions, there is no constitutional prohibition against state taxation of these bodies.

Consequently, in order to achieve a broad based taxation model and avoid any economic distortion where the private sector may be in competition with the state, state governments, municipalities, and their political subdivisions these bodies should be included within the definition of "person."

This leading practice approach would be similar to the current definition of "person" under the current Puerto Rico SUT regime, which already includes the government, its political subdivisions, municipalities, state agencies, bureaus or departments and public corporations.[13] The U.S. federal government and its instrumentalities are also excluded from the definition of person, since "state" means any U.S. state, the District of Columbia or a U.S, possession.[14]

It should be noted that the inclusion of such government bodies within the regime will not result in those bodies ultimately bearing a tax burden as the burden is ultimately born by the end consumer. It merely simplifies the operation of the tax through reducing the number of exemptions and exceptions.

3.A.2 Taxable Activity

Overview of Concept

The concept of "taxable activity" is a central term in a GST system as only goods or services supplied within the course or furtherance of a taxable activity will be subject to the tax. The concept of taxable activity can be related to the concept of "in business" under the current SUT.[15]

VAT/GST jurisdictions use different terms for this concept, including economic activity or business, however the objective of this concept is consistent across most jurisdictions – that any transactions made in the course of a business and not of a personal nature should be included within this term. A key difference between GST and income tax is that GST does not require there to be any intention to make a profit.

Leading Practice

The definition of "Taxable activity" should be drafted to include the following:

- Any activity:
  - Carried on continuously or regularly;
  - Whether or not for profit;

[12] *McCulloch v. Maryland*, 17 U.S. 316 (1819).
[13] PRIRC § 4010.01(bb).
[14] PRIRC § 4010.01(0).
[15] PRIRC § 4010.01(b).

- Involving the supply of goods and services;
- For consideration;
- By any person (which includes public bodies).

- The commencement and ending of a taxable activity.
- Any activity of public bodies that qualify as taxable person.

It is recommended that the definition excludes hobbies and activities of employees.

Discussion

New Zealand defines "taxable activity" as "any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club."[16] The NZ GST Act explicitly includes in this definition the activities of any public authority or any local authority. The NZ GST Act also clarifies that anything done in connection with the beginning or ending of a taxable activity is treated as "taxable activity." Expressly excluded from the term are private recreational pursuits or hobbies and employment.

The IMF Model Law has a similar definition as the NZ GST Act. However, the law explicitly excludes any activity to the extent that the activity involves the making of exempt supplies.[17] Further the exclusion of employment is under the definition of supply, rather than under the definition of taxable activity.

Singapore uses the term "business" rather than "taxable activity." The term "business" is defined as including any trade, profession or vocation.[18] The following is also deemed to be the carrying of business: the provision by any club, association, society, management corporation or organization (for a subscription or other consideration) of the facilities or advantages available to its members or subsidiary proprietors, as the case may be; and the admission, for a consideration, of persons to any premises.[19]

However, any organization which has objects in the public domain and carries on activities which are political, religious, philanthropic or patriotic in nature, cannot be considered as carrying on a business, as it only receives subscriptions from its members without providing any services to the members in return.[20]

Finally, while the Singapore GST Act recognizes that acts done in connection with the termination of a business are treated as being done in the course of that business, it does not address acts

[16] New Zealand GST Act, § 6(1).
[17] IMF Model Law, § 5(2).
[18] Singapore GST Act, § 3(1).
[19] Singapore GST Act, § 3(2).
[20] Singapore GST Act, § 3(3).

done in connection with the beginning of business.[21] However, a person can register for GST in Singapore if he or she intends to make supplies in the course of furtherance of a business.

Malaysia adopted the same definition of "business" and "deemed business" as Singapore.[22] However, the Malaysian GST Act does not exclude from the definition of business subscriptions received by political, religious, philanthropic organizations. In addition, the Malaysian GST Act explicitly states that the commencement and termination of a business is treated as being done in the course of the business.[23]

Ireland also uses the term "business" which is defined as any activity, whatever the purpose or results of that activity, and includes any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, and the exploitation of tangible or intangible property for the purposes of obtaining income there from on a continuing basis.[24]

The GST law should provide a precise definition of "taxable activity." A precise definition of "taxable activity" will promote efficiency, certainty, and effectiveness of the tax.

Common elements of the definition of a taxable activity or business across all of the comparative jurisdictions are as follows:

- An activity that is carried out continuously or regularly – excluding one-time transactions;
- Whether or not for profit.

Key differences include whether the definition includes the requirement that the activity must involve a supply of goods or services for consideration. New Zealand and the IMF adopt such a definition, while the other comparable jurisdictions general imply that there would be consideration for a supply though the use of such terms such as trade or commerce.

Certain jurisdictions explicitly exclude the following within the definition of taxable activity:

- Hobbies or recreational activities;
- Employment (whether expressly or through the operation of other sections of the legislation).

While others practically exclude such activities through either stating the activity must be carried on independently (implying that employment is not included) or through the use of the terms trade or professions (implying that hobbies and recreational activities are excluded).

For certainty and simplicity, leading practice would be to adopt a similar approach to New Zealand and the IMF.

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[21] Singapore GST Act, § 3(6).
[22] Malaysia GST Law, § 3(1) and 3(2).
[23] Malaysia GST Law, § 3(3).
[24] Irish VAT Act, § 2(1).

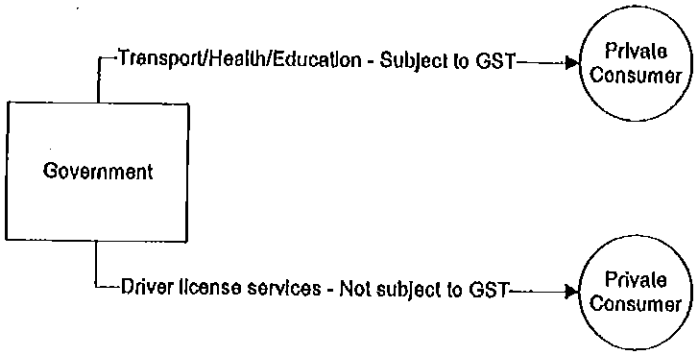
As discussed above in relation to the definition of "Taxable person," the inclusion of public bodies within the scope of a GST is a complex and controversial issue.

The approach adopted by the comparative jurisdictions of taxing public bodies varies significantly, and we summarize these approaches below:

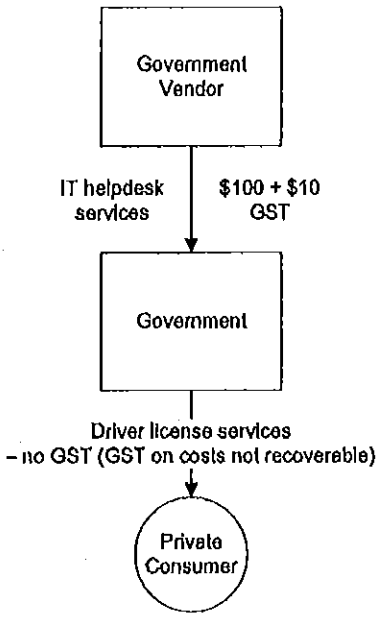
- New Zealand – includes public bodies within the definition of "person" (as discussed above) and "taxable activity". Within the definition of "supply", New Zealand deems most government fees to be consideration for a supply of goods or services.
- Singapore – treats public bodies as falling within the regime through a special provision that deems any supplies made by the government in course of business, except certain excluded supplies, to be subject to GST.
- Ireland and Malaysia – Exclude supplies made by public bodies unless they are in competition with the private sector.
- IMF – Includes the public bodies within the definition of taxable person.

The inclusion of public bodies within the scope of the GST regime promotes neutrality and reduces complexity in the application of the law and helps eliminate any distortion of competition between the public and private sector. It should be noted that the inclusion of such government bodies within the regime will not result in those bodies ultimately bearing a tax burden as the burden is ultimately born by the end consumer. It merely simplifies the operation of the tax through reducing the number of exemptions and exceptions.

A common approach globally is to treat those goods and services provided by the public sector that are in competition with private businesses as subject to GST in order to ensure there is a level playing field with the private sector. Those goods and services provided by the public sector in a non-commercial context are generally considered to be outside the scope of GST – see the below diagram:

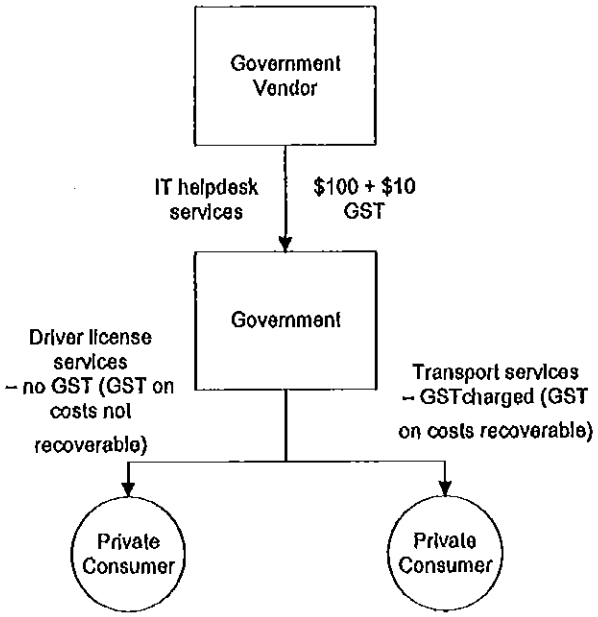


However, there are a number of challenges with this approach. Firstly, one of the biggest issues faced is how to determine whether a public body is in competition with the private sector and therefore should be taxable. Secondly, for those public bodies providing non-commercial services, input tax recovery in respect of GST incurred on their purchases is denied. This can lead to self supply bias and a distortion of production decisions where public bodies are required to minimize costs. See diagram below for illustration.

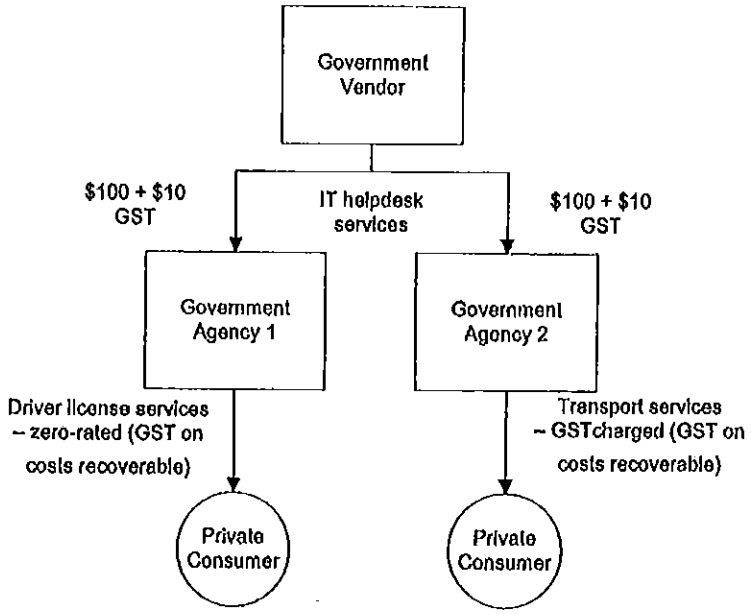


In the above example, the $10 becomes a cash cost to that government department, impacting its budget.

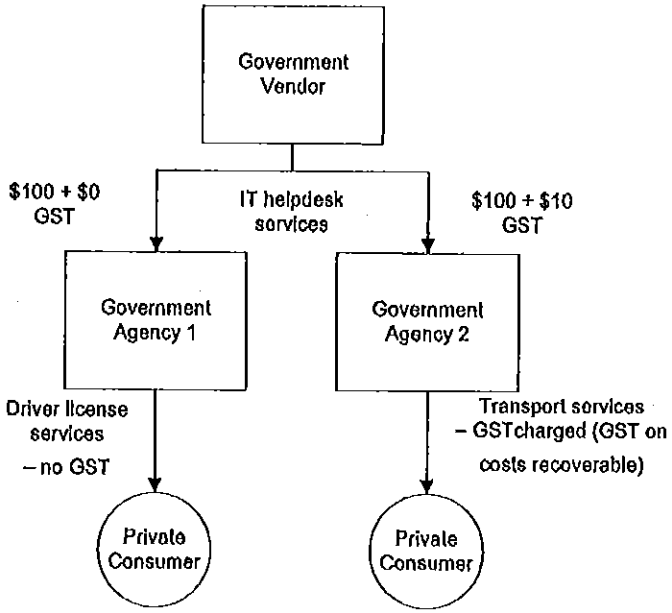
Where public bodies provide both taxable and non-taxable services, input tax apportionment issues can arise, similar to those discussed below in respect of financial services. In the diagram below, the IT helpdesk services are used by the government in the delivery of the transport services (subject to GST) and in the delivery of the driver license services (not subject to GST). The $10 GST charged by the services provider may only be recovered to the extent they are applied to the provision of transport services. Calculating this recovery percentage can result in significant compliance issues. Please refer to sections 3.D.5 and 3.D.6 for a more detailed discussion on input tax recovery and apportionment issues.



Input tax credits for GST on purchases can eliminate this self supply bias and any distortion of input choices – effectively deeming all supplies made by public bodies as zero-rated for GST purposes (other than those competing with the private sector). However the issue of determining whether the public body is in competition with the private sector remains. This is illustrated in the following diagram:

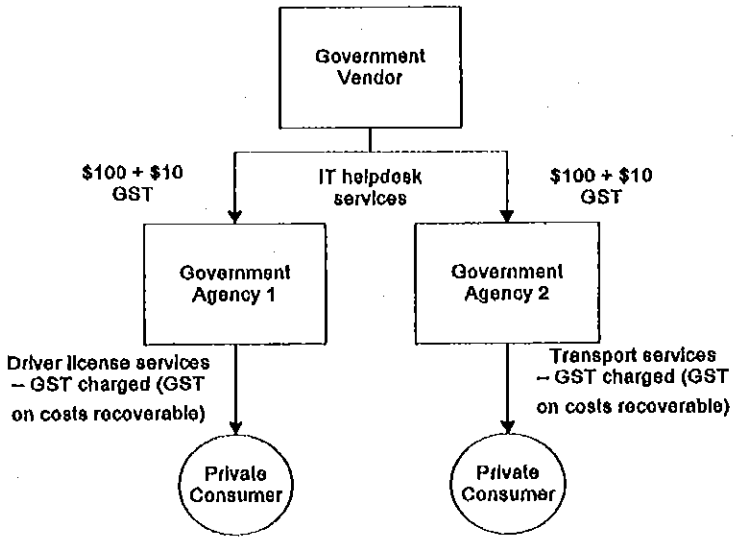


Alternatively, supplies of goods and services made to government bodies not in competition with the private sector can be treated as zero-rated. However, this can create additional complications for suppliers with respect to the requirement to identify whether the particular government body is eligible to receive zero-rated supplies or whether it should be treated as a taxable person as it is in competition with the private sector. This is illustrated in the diagram below:



Further issues are created in respect of those suppliers that primarily contract with government entities perpetually being in a GST refund position, with the associated cash flow impact this has and issues where full refunds of GST are not paid in favor of a carry forward mechanism.

Another approach, as adopted in New Zealand, is to treat the public sector as fully taxable in respect of all of its activities where there is consideration for the goods or services supplied. This eliminates the issues associated with determining whether the supplies made by the public sector are in competition with the private sector and any apportionment issues associated with claiming input tax credits. See diagram below:



The recommendation made by Copenhagen Economics when considering reform of the VAT treatment in the public sector is a full taxation model because it is a future proof model that can deal with any changes in how public and private sector entities compete, promotes a broader base and has lower compliance costs than those associated with the other options.[26]

Such a model would deem all supplies of goods and services by a public body to be subject to GST irrespective of whether they are in competition with the private sector. Further, to eliminate any issues associated with apportionment of input tax credits, public bodies would be deemed to be fully taxable and entitled to recover 100% of VAT incurred on their purchases.

We consider such an approach constitutes a leading practice in the case of Puerto Rico. As such, the definition of taxable activity should include the activities of public bodies in Puerto Rico.

However, the treatment of water and electricity is a special case in Puerto Rico. The pre-tax cost of both of these commodities is already extremely high and subjecting them to an additional GST tax would impose unacceptable additional costs on consumers. As such, a full taxation model may not be appropriate in Puerto Rico in respect of these sectors. As both are supplied by

[26] Copenhagen Economics, *VAT in the Public Sector and Exemptions in the Public Interest*, Final report for TAXUD/2011/DE/334, 10 January 2013.

government authorities and are not in competition with the private sector, such an approach is manageable.

Notwithstanding the discussion above and as discussed under Section 3.A.1, due to constitutional issues, activities of the U.S. government and its instrumentalities cannot perform a "taxable activity" for GST purposes.

3.A.3 Supply

Overview of Concept

This section addresses the definition of supply. A GST is generally designed to bring within its scope every economic transaction subject to limited exceptions.[26] GST laws usually refer to transactions subject to GST as "supplies."[27] The concept of supply can be related to sales of taxable items under the current SUT.[28] GST laws usually divide supplies into "supplies of goods" and "supplies of services." Similarly, the current SUT law divides "taxable items" into tangible personal property, taxable services, and admission fees and combined transactions.[29]

Similar to the current SUT, defining "supply of goods" and "supply services" is important because the nature of the transaction may influence the place of supply rules, the time of the supply, and the person liable to collect the GST.

Leading Practice

The definition of "Goods" should be drafted to include the following:

- All movable and immovable property (personal and real property);
- Utilities such as water and electricity; and
- Excludes money.

The definition of "Supply of Goods" should be drafted to include the following:

- Transfer of the right to dispose of a good as owner.
- A transfer or provision of thermal or electrical energy, heat, gas, refrigeration, air conditioning, or water.

The definition should also include any deemed supplies of goods in accordance with Puerto Rico's commercial laws and economic realities.

The definition of "Services" should be drafted to include the following:

- Anything that is not goods or money.

The definition of "Supply of services" should be drafted to include the following:

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[26]David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996.
[27]David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996, p. 5.
[28]*See* e.g., PRIRC § 4010.01(h).
[29]PRIRC § 4010.01(aa)..

- Anything that is not a supply of goods.

The definition should also include any deemed supplies of goods in accordance with Puerto Rico's commercial laws and economic realities.

Discussion

Definition of "goods"

In New Zealand, the GST Act defines "goods" as including all kinds of personal or real property; but not chooses in action (i.e., a right to use), money, or a product transmitted by a non-resident to a resident by means of a wire, cable, radio, optical or other electromagnetic system, or by means of a similar technical system.[30]

The Malaysian GST Act defines goods as any kind of movable and immovable property, but excludes money except a bank note or coin before it becomes legal tender or a collector's piece.[31]

The IMF Model Law defines "goods" as "all kinds of corporeal movable or immovable property, thermal or electrical energy, heat, gas, refrigeration, air conditioning, and water, but does not include money."[32]

The Irish VAT Act defines "goods" as all moveable and immovable objects (other than things in action or money).[33]

The Singapore GST Act simply defines "goods" as not including money but provides greater guidance in under the definition of "supply of goods", discussed below.[34] Singapore includes the supply of utilities as a supply of goods in the supply of goods definition.

The GST law should define what is considered a "good" for GST purposes.

The common factors across the comparable jurisdictions in relation to the definition of "goods" include:

- All movable and immovable property (personal and real property);
- The exclusion of money.

In addition, leading practice demonstrates that the definition should include utilities such as water and electricity as this removes any complications arising from determining the place of supply of such transactions.

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[30] New Zealand GST Act, § 2.
[31] Malaysia GST Act, § 2.
[32] IMF ModelLaw, § 2.
[33] Irish VAT Act, § 2(1).
[34] Singapore GST Act, § 2(1).

Such a leading practice definition of goods goes beyond the current Puerto Rico definition of "tangible personal property," which does not include automobiles, intangibles, gasoline, electricity, and water.[35]

Definition of "supply of goods"

New Zealand does not provide a separate definition for supply of goods. However, the general definition of "supply" includes all forms of supply.[36] New Zealand has an extensive list of what it is deemed to be a supply of goods, including, goods retained upon deregistration.[37]

In Singapore, the GST Act defines "supply" to include all forms of supply, but not anything done otherwise than for consideration. Moreover, the GST Act provides a non-exhaustive list of transactions that qualify as a "supply of goods."[38] This list states, among other things, that the transfer for the whole property in goods is a supply of goods but a transfer of any undivided share or of the possession of the goods is a supply of services.

The Malaysian GST Act's definition of "supply" includes all forms of supply.[39] The first schedule of the GST Act provides a list of transactions that are classified as a "supply of goods." The list includes, amongst other things, the transfer of the whole property in movable goods, the transfer of land, the supply of utilities, and the transfer of business assets.[40]

The IMF Model Law defines a supply of goods as a transfer of the right to dispose of tangible property as owner, including an agreement of sale and purchase; a transfer or provision of thermal or electrical energy, heat, gas, refrigeration, air conditioning, or water, is a supply of goods; or a supply of goods for goods or services is a supply of goods.[41] Similar to New Zealand, the Model Law also includes a list of certain deemed supplies, such as for lay-bye agreements. However, in contrast to most of the other comparable jurisdictions, the leasing of a good is treated as a supply of goods.

Ireland focuses its definition on the transfer of ownership of the goods.[42]

Other than New Zealand, the definitions adopted by the other comparable jurisdictions focus on the transfer of ownership. Such an approach results in the hiring, renting, or leasing of goods being deemed to be a supply of services. This is the more common approach across the globe.

For clarity and certainty, leading practice would be adopting a more prescriptive approach, such as that adopted by the IMF. Inclusion of the various utilities in the IMF definition removes any uncertainty that may arise from determining whether a person using electricity acquires the right to dispose of the electricity as owner. In addition, similar to New Zealand and the IMF, the definition of supply of goods should also include any deemed supplies of goods based on Puerto

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[35] PRIRC § 4010.01(gg).
[36] NZ GST Act, § 5(1).
[37] New Zealand GST Act, § 2.
[38] Singapore GST Act, § 10(2)
[39] Malaysia GST Act, § 4.
[40] Malaysia GST Act, First Schedule.
[41] IMF Model Law, §4.
[42] Irish VAT Act, § 19.

Rico's commercial laws and economic realities and to facilitate the operation and neutrality of the law (e.g., deemed supply of assets retained upon deregistration where input tax has previously been claimed).

Definition of "services" and "supply of services"

The NZ GST Act defines "services" as anything that is not "goods" or "money."[43] However, New Zealand has an extensive list of what it deems to be a supply of services, which includes gambling and vouchers. New Zealand also deems many payments to public bodies to be in consideration for a supply of goods or services.

Singapore, although not defining "services," defines "supply of services" as anything which is not a supply of goods but is done for consideration (including the granting, assignment or surrender of any right).[44] The Second Schedule of the Singapore GST Act includes the transfer of the possession of goods as a supply of services.

In Malaysia, "services" means anything done or to be done including the granting, assignment or surrender of any right or the making available of any facility or benefit but excludes supply of goods or money.[45] The First Schedule of the GST law provides a list of transactions that are considered a "supply of services" and includes, amongst other things, the transfer of possession of a movable property, leasing or tenancy of land, and treatment or process.[46]

The IMF Model Law also defines services as anything that is not goods or money.[47] In addition, the definition of "supply of services" provides a non-exhaustive list of what is considered supplies of services; e.g., making available any facility or advantage; or refraining from or tolerating any activity.[48]

Ireland does not define "services" but defines "supply of services" as the performance or omission of any act or the toleration of any situation other than the supply of goods. Various other deeming rules exist to treat certain supplies of goods as supplies of services.[49] However, such a prescriptive approach to the definition of services adds complexity and as such, is not recommended.

There is a balance to be struck between having a general definition of "services" and "supply of services" and being prescriptive in the definition with various deeming provisions to help maintain the neutrality of the tax. The comparable jurisdictions differ significantly in respect of their approaches.

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[43] New Zealand GST Act, § 2.
[44] Singapore GST Act, § 10(2)(b).
[45] Malaysia GST Act, § 2.
[46] Malaysia GST Act, First Schedule.
[47] IMF, Model Law, § 1.
[48] IMF Model Law, § 4.
[49] Irish VAT Act, § 26.

Ultimately, the definition adopted will be specific to the business and economic environment in Puerto Rico. However, as a starting point, the definition of "services" and "supply of services" should be as follows:

"Services" – anything that is not goods or money.

"Supply of services" – anything that is not a supply of goods.

The definition of supply should also include any deemed supplies of services based on Puerto Rico's commercial laws and economic realities and that maintain the neutrality of the tax.

Such a leading practice definition departs from the current definition of "taxable services" under the SUT. While the SUT definition includes any service rendered to any person, it does not include, amongst other, intangibles, professional services, and services by the Government of Puerto Rico, educational services, insurance services, and healthcare services.[50]

3.B Imposition of the Tax

3.B.1 Imposition of the Tax

Overview of Concept

This is the main charging provision of the law. It sets out what types of transactions are subject to GST, the territorial scope of the GST and who is required to charge the tax.

Puerto Rico currently has two charging provisions: one for sales tax and another one for the compensatory use tax.[51]

Leading Practice

The main charging provision should be drafted to include the following:

- GST shall be levied on the taxable supply of goods and services made in Puerto Rico by a taxable person in the course of a taxable activity.
- GST shall be levied upon the importation of goods into Puerto Rico.
- GST charged on a supply must be accounted for by the taxable person making the supply
- GST levied upon the importation of the goods is the liability of the importer.

Discussion

Each jurisdiction has a main charging provision which achieves the same results. However, the wording of this charging provision and how it interacts with related sections of the law varies significantly from one jurisdiction to another.

New Zealand's main charging provision states that GST shall be charged on the supply of goods and services in New Zealand by a registered person, in the course or furtherance of a taxable

[50] PRIRC § 4010.01(nn).
[51] PRIRC § 4020.01 and PRIRC § 4020.01.

activity carried on by that person.[52] The charging of GST on the importation of goods into New Zealand is addressed under a separate section.[53] Taxable activity and registered person are defined in the Interpretation Part of the Act. The liability to pay GST is also provided for in a different section.[54]

In contrast, Singapore's main charging provision includes most of the key concepts and rules within the same provision.[55] It states that GST shall be charged on the supply of goods and services in Singapore and the importation of goods into Singapore where it is taxable supply made by a taxable person in the course or furtherance of a business carried on by him. Further the section also states that the tax charged is the liability of the person making the supply.

As discussed above, the term taxable person and business are effectively equivalent to the New Zealand terms of registered person and taxable activity. Therefore the key difference between the two jurisdictions is Singapore's inclusion of the importation GST charging provision within the main charging provision.

The IMF, in section 9 of Model Law, and Malaysia, in section 9 of the Malaysia GST Act, adopt a very similar approach to Singapore.

The Irish VAT Act's main charging states that a supply for consideration of goods or services made by a taxable person acting in that capacity where the supply is made in Ireland, is subject to VAT. In addition, the charging provision includes the levying of VAT upon the importation of goods.[56]

The Singaporean approach is preferred over the New Zealand approach as it includes the provision charging GST on the importation of the goods within the main charging provision. Further, this approach clearly sets out who is liable to account for the tax compared to the New Zealand approach which sets out this rule following the calculation of the tax payable in a particular period.

3.B.2 Place of supply

Overview of Concept

The place of supply rules determine whether a supply of goods or services is deemed to be made within Puerto Rico and therefore, whether the supply is subject to the charging provision. These

[52] New Zealand GST Act, § 8.
[53] New Zealand GST Act, § 12.
[54] New Zealand GST Act, § 20.
[55] Singapore GST Act, §s 7 and 8.
[56] Irish VAT Act, § 3.

rules are conceptually similar to the rules for determining the source of the income generated by the sale of taxable items under the current SUT.[57]

One of the biggest issues in respect of the place of supply concept is the GST treatment of cross border transactions. This is the current focus of international discussions and the area which has seen the most recent development.

There is widespread consensus that the destination principle (that goods and services should be subject to tax in the country of destination or where they are consumed - following the core principle that GST is a tax on consumption) is preferable to the origin principal from both a theoretical and practical standpoint.[58]The destination principle preserves the intended neutrality of the tax with respect to international trade.

Cross border transactions involving goods is a fairly straight forward issue – imports should be subject to GST and exports should be zero-rated. This is in line with the destination principle and ensures that imported goods are placed on a level playing field with domestically produced goods and exporters are not competitively disadvantaged on the world market with local GST either being charged to foreign purchasers or being an embedded cost on the supply chain. We refer to the Zero-rating section (3.B.8) for a discussion of the effect that zero-rating has on the supply chain.

The GST treatment of the cross-border trade in services is more complex as there are no border controls such as those which facilitate the efficient taxation of goods. Further, actual consumption or use of services is often difficult to track so proxies are often used to determine the place of supply of services.

While most jurisdictions apply the destination principle in respect of the application of GST, subtle variances in each jurisdiction's rules can result in double taxation, non-taxation, and uncertainties for businesses and tax authorities. Such uncertainties and inconsistent treatment can result in distortions of consumer and business consumption decisions in respect of cross border transactions. This prompted the OECD to develop international VAT/GST guidelines to provide guidance to governments on apply VAT to cross border trade.[59]

In addition to the general VAT neutrality guidelines mentioned above, the OECD Guidelines also set out GST principles for international trade. These key principles have been taken into account when determining the leading practice for the GST place of supply rules and zero-rating rules discussed below.

To effectively manage the neutrality of the tax, the place supply rules are interdependent with the importation of goods, zero-rating and the imported services rules.

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[57]PRIRC § 4020.03.

[58] OECD (2012), *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administrative Issues*, OECD Publishing, p. 34.

[59]*OECD International VAT/GST Guidelines.*

Leading Practice

The place of supply rules should be drafted to include the following:

- Place of supply of goods:
  - Where the goods are located at the time of supply.
- Place of supply of services:
  - If the supplier is established in Puerto Rico, the place of the supply is in Puerto Rico;
  - If the supplier is not established in Puerto Rico, the place is outside Puerto Rico unless the services are physically performed in Puerto Rico.

Where necessary, the GST law should include specific place of supply rules for deemed supplies.

Discussion

New Zealand has adopted very broad place of supply rules from a jurisdictional perspective. In practice however, these rules do not impose GST on a greater range of supplies in comparison to other jurisdictions. However, it can result in the requirement to treat certain supplies as zero-rated where other jurisdictions would treat such supplies as out of scope, thus resulting in a reporting obligation in respect of those supplies.

New Zealand includes its place of supply rules in its main charging provision.[60] The primary rule is based on the residency of the supplier - goods and services are deemed to be supplied in New Zealand if the supplier is resident in New Zealand (with zero-rating rules applying to maintain the destination principle) and deemed to be supplied outside New Zealand if the supplier is non-resident in New Zealand. However, this primary rule has a number of exceptions to ensure the destination principal is maintained.

If the supplier is a non-resident, a supply of goods is deemed to be supplied in New Zealand if the goods are in New Zealand at the time of supply (earlier of invoice issuance or payment). A supply of services is deemed to be supplied in New Zealand by a non-resident if the services are physically performed in New Zealand by a person who is in New Zealand at the time the services are performed. In order to avoid the unnecessary registration of non-residents, where goods and services are deemed to be supplied in New Zealand but are supplied to a person who can claim a credit for any GST charged, the supply is deemed to be made outside of New Zealand.

Finally, New Zealand also has a reverse charge rule for services not performed in New Zealand that are received by a taxable person that is unable to claim a full input tax credit. In such cases the services are deemed to be made in New Zealand and the recipient is required to account for the GST (refer to section 3.B.4 below for a discussion on reverse charge).

New Zealand also has specific rules in relation to telecommunications suppliers.

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[60] New Zealand GST Act, § 8.

Singapore focuses on the transport of goods for determining the place of supply.[61] A supply of goods is treated as being supplied in Singapore if the supply does not involve their removal to or from Singapore. Further, if the supply involves the removal of the goods from Singapore, then the goods are deemed to be supplied in Singapore (potentially subject to zero-rating as an export). If the supply involves the removal of the goods to Singapore, the supply is deemed to be outside of Singapore.

In respect of supplies of services, services are treated as supplied in Singapore if the supplier belongs in Singapore and are not treated as supplied in Singapore if the supplier belongs outside of Singapore. The "belongs" test is similar to the New Zealand residence test focusing on the supplier's presence in the country.

Malaysia has adopted similar rules as Singapore in section 12 of the Malaysian GST Act.

The key difference between the New Zealand approach and the Malaysian and Singaporean approaches relates to the treatment of services. While all three countries tax a supply of services by a business established in the jurisdiction (with zero-rating rating rules applying for certain exported services), only New Zealand taxes services physically performed in the country by a non-resident, potentially resulting in a non-resident being required to register for GST in New Zealand. Malaysia and Singapore do, to a certain extent tax services physically performed in their respective countries by non-established entities through their reverse charge regimes (we discuss the reverse charge regimes in section 3.B.4 below). However, many services can escape the tax net. As such the New Zealand approach is preferred.

The IMF Model Law adopts the approach of the EU that was in place prior to 2010.[62] While the place of supply rules for goods remain unchanged, the EU substantially changed the place of supply rules for services to have more of a destination principle focused VAT. Given a destination principle is regarded as leading practice, we do not consider the IMF Model VAT Law place of supply rules to be an appropriate comparable and do not discuss these rules in detail.

The place of supply rules as implemented by Ireland are as follows.

A supply of goods is deemed to take place where the goods are made available to the supplier. If the supply of the goods involves transportation of those goods, then the place of supply is deemed to take place where the transport begins.[63]

The Irish VAT Act also provides specific rules for the supply of electricity, water and similar utilities; being where the supply is received.[64]

Supplies of services in a business to business transaction are deemed to take place where the customer is located.[65] However, various exceptions to this general rule include:

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[61] Singapore GST Act, § 13.
[62] IMF Model Law, § 12.
[63] Irish VAT Act, § 29 - 30.
[64] Irish VAT Act, § 31.
[65] Irish VAT Act, § 33 - 34.

- Supplies connected with immovable property – where the property is located.
- Passenger transport – where the transport takes place.
- Admission to certain cultural, artistic and sporting activities – where the event takes place.
- Restaurant and catering services – where the services are physically carried out.
- Restaurant and catering services onboard ships, aircraft and trains – the place of departure.
- Short term hiring of means of transport (less than 30 days) –where the means of transport is collected.

Supplies of services in a business to consumer transaction are deemed to take place where the supplier is located. However, various exceptions to this general rule also exist, including:

- Services provided by an intermediary – taxed where the main transaction takes place.
- Supplies connected with immovable property – where the property is located.
- Valuation of, or work on, tangible personal property – where the services are physically delivered.
- Passenger transport – where the transport takes place.
- Transport of goods – where the transport takes place.
- Ancillary services to the transport of goods – where the service are physically performed.
- Any service related to certain cultural, artistic and sporting activities – where the event takes place.
- Restaurant and catering services – where the services are physically carried out.
- Restaurant and catering services onboard ships, aircraft and trains – the place of departure.
- Short term hiring of means of transport (less than 30 days) – where the means of transport is collected.
- Long term hiring of means of transport (more than 30 days) – where the customer is located.
- Electronically supplied services, radio and television broadcasting services and telecommunication services – the location of the customer (post 2015).
- Advertising, consulting and legal services, financial services, transferring trademarks, patents and similar rights – where the customer is located.
- Restraint of trade – where the customer is located.
- Supply of staff – where the customer is located.
- Hiring of moveable tangible property (other than means of transport) – where the customer is located.

There are various other place of supply rules and use and enjoyment rules that override the above.[66]

The prescriptive nature of the Irish place of supply rules, while effectively achieving a destination principle VAT system (with certain exceptions) create barriers to compliance due to their complexity.

For this reason, and the reason discussed above in respect of the Malaysian and Singaporean rules, adopting place of supply rules similar to the New Zealand model constitute leading practice. The GST law should, where necessary, provide specific place of supply rules for deemed transactions. In addition, special taxation provisions should be created for telecommunication, broadcasting and electronic supplies services provided to final consumers in Puerto Rico by non-residents in order to ensure that the destination principle is maintained. Because the latter constitute specific transactions, the specific taxation rules for these transactions should be addressed outside the main taxing provisions as a Special Case.

3.B.3 Time of Supply

Overview of concept

The time of supply rules primarily determine when VAT should be accounted for in respect of a supply (i.e., the period/return in which the transaction should be reported). However, it also sets a reference point for when a tax invoice should be issued (e.g. within 21 days of the time of supply) and can be used as a reference point for determining the place of supply (e.g., the place of supply of goods is where they are located at the time of supply).

Leading Practice

The time of supply rules should be drafted to include the following:

- The time of supply is the earlier of:
  - The issuance of any invoice;
  - The receipt of any payment; or
  - The delivery of making available of the goods or the completion of the performance of the services.
- For continuous supplies, the time of supply should be deemed to occur when each successive payment is made or becomes due or when an in invoice relating to that payment is issued.

Specific time of supply rules should be drafted for such supplies as gambling, vouchers, imported goods, imported services and should be addressed under their respective provisions.

[66] Irish VAT Act, § 35.

Discussion

New Zealand takes a very simplistic approach with its basic time of supply rule.[67] The time of supply is the earlier of the issuance of an invoice or the receipt of any payment. This basic rule is modified in the case of supplies between associated persons to ensure that the liability to account for GST is not artificially deferred. In such cases, the time of supply is deemed to be as follows where no invoice or payment has been made:

- For supplies of goods:
  - If the goods are to be removed, at the time of the removal.
  - If the goods are not to be removed, at the time they are made available to the recipient.
- For supplies of services:
  - The time the services are performed.
  - For related party imported services, the end of the taxable period that is 2 months after the first balance date of the recipient following the performance of the services.

Special rules also exist for layaway arrangements (when title is transferred), lotteries, casinos, vending machines, supplies by government authorities, major construction, hire purchase agreements and vouchers. Further, where goods or services are supplied under an agreement which provides for periodic payments, the time of supply is triggered at the point when each successive payment is made or becomes due or when an in invoice relating to that payment is issued.

Singapore has the same general time of supply rule as New Zealand – earlier of invoice or payment – but it is modified to state "to the extent that the supply is covered by the invoice or consideration."[68] However, Singapore's exception to this rule, which is drafted in the same manner as New Zealand's, does not apply to associated persons but applies to specific supplies that are listed in the legislation, including:

- A supply of goods consisting of the grant, assignment or surrender of any interest or right over land;
- Where a taxpayer has applied to the Comptroller to apply this exception to the general time of supply rules; and
- A supply by an agent that is deemed to be made by him as principal under a specific provision of the law.

The Singaporean law then provides specific rules for the following:

- When input tax may be claimed – general rule;
- Calculation of turnover threshold for registration purposes – general rule;

[67] New Zealand GST Act, § 9.
[68] Singapore GST Act, § 11.

- Disposal of assets of a business for no consideration – at the time the goods are transferred or disposed of;
- Business assets used for private purposes for no consideration – the last day of the accounting period in which the goods were used for private purposes;
- Where goods are provided on a trial basis – at the end of 12 months following the goods removal if no invoice or payment has been issued or received;
- Where goods or services are made available to a non-registered person prior to the seller's registration but invoiced after registration – there is a choice on how to treat the transaction;
- Where the parties are associated persons and no invoice has been issued or consideration paid – at the end of 12 months after the goods have been removed;
- Financial services paid on installments – treated as wholly taking place at the time when the invoice for the first installment is issued or paid; and
- Where a person deregisters from GST after the goods are made available or removed or the services are performed and issues an invoice/receives payment after deregistration – the time of supply is the day immediately before deregistration (this is included in the definition of supply in the New Zealand law).

The Comptroller may also alter the time of supply at the request of the taxable person. The GST regulations provide certain exceptions to the associated persons' time of the supply rule, and rules around continuous supplies of services where payments are made periodically.

Malaysia takes a more complex approach to the general time of supply rule.[69] For goods the time of supply is as follows:

- At the time of the removal of the goods if the goods are to be removed;
- At the time when the goods are made available to the recipient if the goods are not to be removed;
- Where goods are provided on a trial basis – the time when it because certain that a taxable supply has taken place or 12 months after removed, whichever is earlier.

For the supply of services, the time of supply is when the services are performed.

Notwithstanding the above rules, if a tax invoice is issued or payment is made prior to the above tax point being triggered, then the invoice or payment will trigger the time of supply to the extent the payment or invoice covers the supply. However, if a tax invoice is issued within 21 days of the time of supply determined under the basic rule, the date the tax invoice is issued becomes the tax point.

The Director General may also alter the time of supply at the request of the taxable person.

[69] Malaysia GST Law, § 11.

Malaysia also has specific rules as follows:

- Disposal of assets of a business – at the time the goods are transferred or disposed of; and
- Business assets used for private purposes – at the time when the goods were used for private purposes.

The regulations provide further rules for periodic supplies/payments by installment.

The time of supply rules under the IMF Model VAT Law effectively takes elements from a number of jurisdictions.[70]

The primary rule is that the time of supply is the earlier of:

- The delivery or making available of the goods or the completion of the performance of the services;
- The issuance of an invoice; or
- The receipt of any payment.

Specific rules are provided for:

- The supply of goods under a credit agreement – at the time the agreement is entered into;
- The supply of goods under a lay-bye agreement – at the time the goods are delivered to the purchaser;
- The making available of goods for private or employee use – at the time the goods are applied to that use;
- The deemed supply of repossessed goods by the debtor to the creditor – at the time of repossession;
- The deemed supply of services under a cancelled lay-bye agreement – when the seller obtains the right to retain any amounts paid by the purchaser;
- Supplies made through vending or other coin operated machines – when the money is removed from the machine;
- Goods under a rental agreement or supplies under an agreement which provides for periodic payments – when each payment is due or received;
- For major construction work or utilities where payments are due periodically – the earlier of the when the payment is due, made or when an invoice is issued; and
- Tokens, vouchers, forfeiture of deposits, deemed supply of good on hand at deregistration.

[70] IMF Model Law, § 10.

The Irish time of supply rules are as follows:[71]

- For B2B transactions, the date of the issuance of the invoice or when the invoice should have been issued;
- For B2C continuous supplies of telecommunication, gas and electricity, when a statement of account is issued;
- For all other B2C supplies, when the goods or services are supplied; and
- For advance payments, if the goods or services are yet to be supplied, then the time of supply is triggered at the time of payment to the extent payment has been received. If received after the supply of the goods or services but before invoice, then the time of supply is triggered at the time of payment for the full value of the supply.

Various other specific time of supply rules are provided, similar the various specific rules noted for the other jurisdictions.[72]

Given the greater risk of fraud in Puerto Rico, it is likely the New Zealand and Singapore approach of relying solely on the issuance of an invoice or receipt of any payment to trigger the time of supply could create greater opportunities to artificially defer tax liability. Further, the complexities of the Irish and Malaysian rules do not promote the principle of simplicity. As such, we consider the better approach would be the IMF Model Law.

The GST law should also, where required, provide specific time of supply rules for deemed supplies if not addressed under Special Cases.

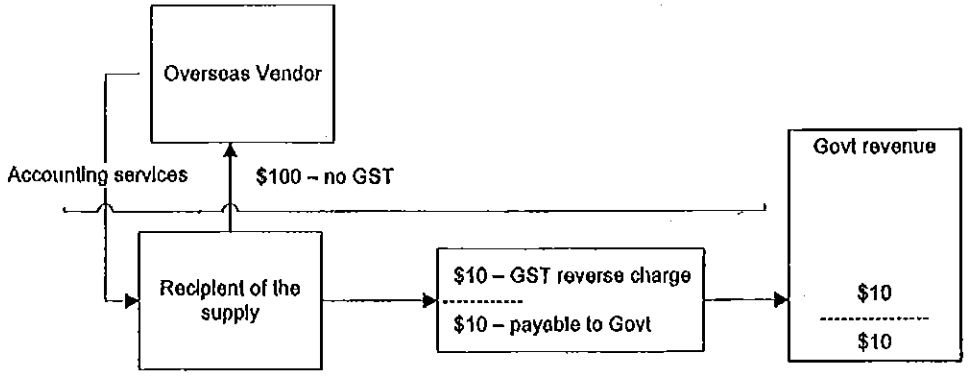
3.B.4 Imported Services/Reverse charge

Overview of Concept

In order to effectively maintain the neutrality of a GST and minimize the compliance obligations placed on non-residents that do not have any presence in the jurisdiction, many jurisdictions adopt an imported services or reverse charge regime. Such a regime generally deems services acquired by residents from overseas to be self-supplied by the resident recipient with the recipient being required to account for GST on that transaction (akin to a use tax).

An example of how the reverse charge operates is noted in the diagram below (assuming a 10% GST rate with no recovery for the recipient of the supply):

[71] Irish VAT Act, § 74.
[72] Irish VAT Act, § 76.



Such a regime relieves any potential distortion in the economic decision of a resident of whether to purchase domestic services or services from overseas and creates a level playing field for domestic and international supplies, preserving the neutrality of the tax.

Leading Practice

The imported services/reverse charge rules should be drafted to include the following:

- Where services are supplied by a non-resident to a person in Puerto Rico, that are not otherwise deemed to be supplied in Puerto Rico under the place of supply rules, the supply should be deemed to be supplied in Puerto Rico by the recipient of the supply.
- The provision should not apply if the recipient is able to claim a full input tax credit in respect of the service received.

Discussion

New Zealand includes its reverse charge regime under the place of supply provision.[73] It states that where a supply is made by a non-resident and it is not deemed to be supplied in New Zealand under any other place of supply rules, that the supply is deemed to be made in New Zealand. A provision within the definition of supply then deems this transaction to be made by the recipient, therefore requiring the recipient to account for tax on the transaction. However, these provisions only apply where the recipient is not in a position to claim full input tax credits for any GST charged. If the recipient can claim full input tax credits, then the reverse charge would simply be an accounting exercise creating an additional compliance burden with no benefit to the revenue authority.

Singapore imposes a reverse charge regime under a discrete section that includes not only the deeming of the supply to be made in Singapore by the taxable person but also sets out the time of supply and valuation rules.[74] Technically this section also applies irrespective of the input tax recovery position of the recipient. This is in contrast to the New Zealand approach which includes valuation and time of supply in relation to such transactions under those respective sections. We do note that Singapore is yet to enforce this reverse charge provision.

[73] NZ GST Act, § 8(4B).
[74] Singapore GST Act, § 14.

Malaysia adopts a similar approach to Singapore.[75]

The IMF Model Law takes a completely different approach by including the importation of services within the main charging provision of the Act[76] and then defining the importation of services within the definitions section.[77] However, similar to New Zealand, there is no requirement to account for the reverse charge where a full input tax credit may be claimed. Unusually, the IMF Model Law then requires an import of services declaration to be made to the Commissioner and pay the tax within 20 days of the end of the taxable period in which the service were imported.[78]

Ireland addresses imported services through the place of supply and the liability rules.[79] Where a supply of services is deemed to be made in Ireland and the supplier is not VAT registered nor has an establishment in Ireland, the liability to account for the tax falls on the recipient. This rule applies irrespective of whether the recipient can claim a full input tax credit in respect of the transaction.

To meet the neutrality objective of a GST and promote the destination principle, leading practice would be to adopt a reverse charge regime for imported services. It is recommended that a combination of the New Zealand and Singaporean approach be adopted – the Singaporean approach of including the importation of services provisions in a separate section but not requiring the reverse charge to be accounted for when a full input tax credit may be claimed by the recipient for simplicity purposes.

3.B.5 Value of the Supply

Overview of concept

The rules governing the value of the supply determines the taxable base upon which the VAT rate will be applied.

Leading Practice

It is recommended that the valuation rules be drafted to include the following:

- The value of the supply is, with/without the addition of tax charged (depending on the commercial laws of Puerto Rico), equal to the consideration for the supply. For imported services, the value should be, without the addition of tax charged, equal to the consideration for the supply.
- The value of supplies of services between related parties below the open market value should be the open market value unless the recipient can claim an input tax credit for any tax charged.

[75] Malaysia GST Act, § 13.
[76] IMF Model Law, § 9.
[77] IMF Model Law, § 2.
[78] IMF Model Law, § 19.
[79] Irish VAT Act, § 12 and 34.

- If the consideration is not in money, it is the open market value of the consideration.
- The value of the supply should include any other taxes, duties or levies (or similar charges).

Specific valuation rules should be adopted for deemed supplies, specific transaction, or special cases that are not adequately dealt with in the general valuation provisions.

Discussion

The general rule under the New Zealand law is that the value of the supply of goods and services shall be, with the addition of tax charged, equal to the consideration for the supply. If the consideration is in money, it is the amount of money payable. If the consideration is not in money, it is the open market value of the consideration.[80] An exception to this tax inclusive valuation of the supplies is in respect of imported services subject to the reverse charge regime. In such cases the value is treated as the consideration for the supply before the addition of tax.

If a supply is between associated persons and is made for no consideration, or consideration that is less than the open market value of the supply, then the supply is treated as the open market value, unless the recipient could claim an input tax credit for any tax charged.

There are a number of rules that are specific to the New Zealand regime which are not relevant here and, as such, are not discussed. However, relevant specific valuation rules include the following:

- Imported services subject to the reverse charge where those services are supplied between related parties;
- Credit contracts to exclude any interest component;
- Long term residential accommodation in a commercial establishment;
- Fringe benefits provided to employees;
- Deemed sale of business assets upon deregistration;
- Deemed supply of services following the cancellation of a lay-by sale;
- Supplies by government bodies;
- Betting, gambling and casinos; and
- Certain cross border intra- group company transactions.

The New Zealand valuation provision also addresses mixed supplies – where the consideration relates to both taxable and non-taxable supplies. In such cases, the consideration should be apportioned to the relevant parts of the supply.

The Singapore GST Act adopts the same general valuation rules as New Zealand.[81] Further Singapore has a similar associated person rule for when there is no consideration or the

[80] New Zealand GST Act, § 10.

[81] Singapore GST Act, § 17 and Third Schedule.

consideration is less than open market value however, the uplift to open market value is at the discretion of the Comptroller.

Singapore has specific rules to address the valuation of the following:

- Valuation rules for the disposal or business assets or the deemed disposal of business assets upon ceasing to be a taxable person;
- Provision of food and beverages or hotel accommodation (or similar) to employees;
- The inclusion of other taxes or duties in the taxable base;
- Leasing of residential premises; and
- Used motor vehicles.

Malaysia has a similar general valuation rule as New Zealand and Singapore, with the exception of the treatment of supplies made for no consideration. In such cases the value is deemed to be the open market value irrespective of the relationship between the parties.[82]

Malaysia also provides the Director General the power to deem a sale to be at open market retail value where the goods are sold by a registered person to non-registered persons for resale.[83]

Malaysia provides a similar valuation rule as New Zealand for gambling.

The IMF Model Law is similar to New Zealand.

The IMF Model Law provides a number of special valuation rules, as follows:

- Credit agreements to exclude any interest component;
- Value of the deemed supply upon repossession of goods;
- Deemed supply of services following the cancellation of a lay by sale;
- Vouchers;
- Betting;
- Deemed supply where a part of the transfer of a going concern is acquired for non-business use;
- Deemed sale of business assets upon deregistration.

The Irish valuation rule states the amount on which tax is chargeable is the total consideration which the person supplying goods or services becomes entitled to receive, including all taxes, commissions, costs and charges, but not including value-added tax chargeable in respect of that supply.[84]

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[82] Malaysia GST Act, § 16.
[83] Malaysia GST Act, Schedule 3, subparagraph 6.
[84] Irish VAT Act, § 37.

Where the consideration does not consist of or does not consist wholly of an amount of money, the amount on which tax is chargeable shall be the total amount of money which might reasonably be expected to be charged if the consideration consisted entirely of an amount of money equal to the open market price.

The Commissioner has a discretion to determine the value of a transaction, based on the open market value of the supply, to ensure the correct amount of VAT is paid.[85]

Specific valuation rules are provided for such things as vouchers, reverse charge, and non-business use of immovable goods.

The approach to the valuation rules by each jurisdiction is very similar. However, Ireland treats the consideration as VAT exclusive while the other jurisdictions treat the consideration as GST inclusive. The ultimate decision on whether to treat the consideration as being GST inclusive or exclusive for the purposes of the GST valuation rules will depend on the commercial or consumer laws of Puerto Rico. However, for imported services, the consideration should be deemed to be GST exclusive.

In any event, the valuation for GST purposes should include any other taxes, duties, levies paid on that supply because GST is not an alternative to those taxes and the value of the supply including those taxes represents the real value of the final consumption of the good or service.[86]

The use of the open market value uplift should be limited and prescriptive, similar to the New Zealand approach, rather than be discretionary such as in Ireland and Singapore in order to provide certainty within the tax system.

Specific valuation rules should be adopted for deemed supplies, specific transactions or special cases that are not adequately dealt with in the general valuation provisions.

3.B.6 Imported Goods

Overview of Concept

A key concept of GST is the levying of the tax on imported goods. As mentioned above in respect of the place of supply rules, this is consistent with the destination principle and ensures that imported goods are placed on a level playing field with domestically produced goods.

Key challenges that will need to be addressed relate to the importation of goods into Puerto Rico from the United States given Puerto Rico's relationship with the United States.

Leading Practice

The levying of GST upon the importation of goods should be included within the main charging provision, as discussed above.

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[85] Irish VAT Act, § 38.

[86] David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996, p. 45.

However, this specific section should address the time at which a good is considered to be imported (e.g., when the goods are cleared by customs) and any import GST suspension or relief regimes.

The provision should provide relief for certain importations by contract or toll manufacturing operations and in respect of the temporary importation of goods.

For taxable persons in good standing, a GST deferral regime should be available to allow those taxable persons to self account for import GST in their GST returns, relieving them of any cash flow burden that may arise from having to pay the GST to release the goods at the border and the subsequent claiming of a credit in the later return.

Discussion

As discussed above in respect of the imposition of the tax, New Zealand has a separate section that imposes GST on upon importation (other than fine metals).[87] This is in contrast to the other comparable jurisdictions, which include the importation of goods within their respective main charging provision.

The charging provision refers to the Customs Laws to determine when goods are considered to be imported into New Zealand. As such, any relief provisions under the Customs Laws (e.g., temporary importation) also apply to the GST.

Within this section, New Zealand also sets out various rules in respect of when GST should not be applied upon importation, including:

- Goods intended solely for the use of an organization, visiting force, expedition or other body approved by New Zealand Customs that may be established or temporarily based in New Zealand under a government or international agreement; and
- Goods intended for the use of a person temporarily resident in New Zealand for the purposes of serving as a member of any of the above organizations.

The section also sets out the value of the imported goods for the purposes of levying the GST.

Further, reliefs are provided for reimported goods (where the importer is the same person as the exporter and the goods were not treated as a zero-rated exported supply).

Various provisions are included to address the refund of GST for goods re-exported from the country where the importer was not entitled to an input tax credit and the goods were of the wrong specification or were faulty.

Additional exemptions are provided for certain specified items under the New Zealand Tariff including:

- Certain gifts;

[87] New Zealand GST Act, § 12.

- Personal baggage and effects (subject to certain limits); and
- Limited amounts of alcohol and tobacco.

Singapore imposes GST on importation in the main charging section of the act, effectively treating GST as if it were a customs duty and all goods imported into Singapore are dutiable. Exemption from import GST for investment precious metals is separately provided for.

Singapore provides discretion to the Minister to issue orders granting relief from import GST for such things as re-imported goods, temporary imported goods, and goods related to an international agreement or arrangement. In addition, similar to the New Zealand law, Singapore defers to the customs legislation for the levying of GST unless there is contrary intention noted in the GST law.

The Singapore GST Act also provides the Minister with the power to issue regulations relieving or deferring the levying or payment of GST where goods are imported by any taxable person in the course of that persons business.[88]

Such schemes include:[89]

- The exemption of the importation of petroleum products where imported for the business of the taxable person;
- Exemption of imports by persons approved under the Major Exporter Scheme and approved third party logistics company scheme (this is a scheme available to taxable persons where the majority of their supplies are exports or supplies of international services);
- Approved import suspension scheme (for taxable persons in the aerospace industry);
- Import Goods and Services Tax Deferment Scheme (allows taxable persons to self account for import GST in their tax return);
- Approved contract manufacturer scheme (where the taxable person carries out work on goods under contract with an overseas person); and
- Approved refiner scheme (who imports investment precious metals and make supplies of refining or supplying such metals).

Malaysia is similar to Singapore in that the charging provision for the levying of GST on importation is in the main charging provision.[90] Malaysia has a number of special regimes, very similar to a number of Singaporean regimes.

The IMF Model Law also has the levying of VAT on importation in the main charging provision.[91] The exemption from import VAT is covered by section 17, referring to Schedule III, which essentially states that import VAT is not payable if the goods are not dutiable. Further, if the

[88] Singapore GST Act, § 27 and 27A.
[89] Singapore GST Regulations, Part IV.
[90] Malaysia GST Act , § 9.
[91] IMF Model Law, § 9.

supply of the goods within the country would be zero-rated or exempt, then no import VAT should apply.

The IMF Model Law also includes a section providing the Commissioner of Customs with the obligation to collect the VAT and requires the importer to provide the Commissioner with an import declaration.

Ireland levies VAT upon the importation of goods in the main charging provision.[92] Ireland includes the following exemptions or reliefs from import VAT:[93]

- Import into a free trade zone;
- Imports into customs warehouse;
- Inward processing arrangements (similar to the contract and toll manufacturing schemes in Malaysia and Singapore);
- Temporary importation arrangement;
- Transit arrangement;
- A regime similar to Singapore's major exporter scheme; and
- A deferred payment scheme.

All comparable jurisdictions levy GST on the import of goods within the territory. This is in line with the current SUT regime, under which use tax must be paid upon importation of goods into Puerto Rico before the person takes possession of the goods.[94]

Amongst the comparable jurisdictions, only New Zealand does not include the levying of GST upon importation within the main charging provision. For clarity purposes, the leading practice would be to follow Singapore, Malaysia, the IMF, and Ireland in this respect.

The section should also address the point in time that a good is considered to be imported (e.g., when the goods are cleared by customs) and any import GST suspension or relief regimes. For this purpose the comparable jurisdictions generally refer to the customs laws.

Given Puerto Rico's economy, special consideration should be given to regimes related to contract or toll manufacturing operations and the temporary importation of goods, which would eliminate the levying of import GST in certain prescribed situations. For example, the importation of raw materials for processing into final goods that are to be exported from Puerto Rico.

For taxable persons in good standing, a GST deferral regime should be available to allow those taxable persons to self account for import GST in their GST returns, relieving them of any cash flow burden that may arise from having to pay the GST to release the goods at the border and the subsequent claiming of a credit in the later return.

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[92] Irish VAT Act§ 3.
[93] Irish VAT Act, §s 53 to 58.
[94]PRIRC § 4042.03(a).

In this regard, the special schemes in Singapore, Malaysia, and Ireland should be considered and adapted to Puerto Rico's needs.

Like the existing rule for collection of sales tax on sales by mail order,[95] the GST law should also address separately the specific case of mail order deliveries to private individuals from the U.S.

3.B.7 Value of Imported Goods

Overview of Concept

It is common to have separate valuation rules for the importation of goods that refer to the customs valuation rules. This reduces an administrative complexities that would arise if the valuation for GST purposes is different than for customs purposes but the GST is levied and collected using the same mechanism as for the collection of duties. Further, such valuation rules assist in determining the taxable base for GST purposes where there is no reference transaction.

Leading Practice

The valuation rules for levying the GST on the importation of goods into Puerto Rico should be based on the customs valuation rules, plus any duties or levies payable upon importation.

Discussion

The New Zealand charging section for levying GST on imported goods also sets out the value of the imported goods for the purposes of levying the GST. The valuation provisions refer to the customs valuation rules plus any other duties or levies payable upon importation.[96]

The IMF, Ireland, Singapore, and Malaysia have separate valuation sections.[97] All sections refer to the valuation prescribed under the customs laws and operate in the same manner as New Zealand.

3.B.8 Zero-rated Supplies

Overview of Concept

Where a supply of a good or service is zero-rated, no GST is charged on the sale or provision of that service. However, the person making that supply is able to recover the GST it has incurred on its purchases related to the making of that zero-rated supply (contrast this with exempt supplies below).

The main issue with zero-rating, is that the entire supply chain is relieved from tax if zero-rating is at the final stage of the chain as illustrated in the diagram below. As such, zero-rating is more costly to the government in terms of revenue foregone. Further, zero-rating requires more controls to ensure refunds claimed by taxable persons making zero-rated supplies are valid.

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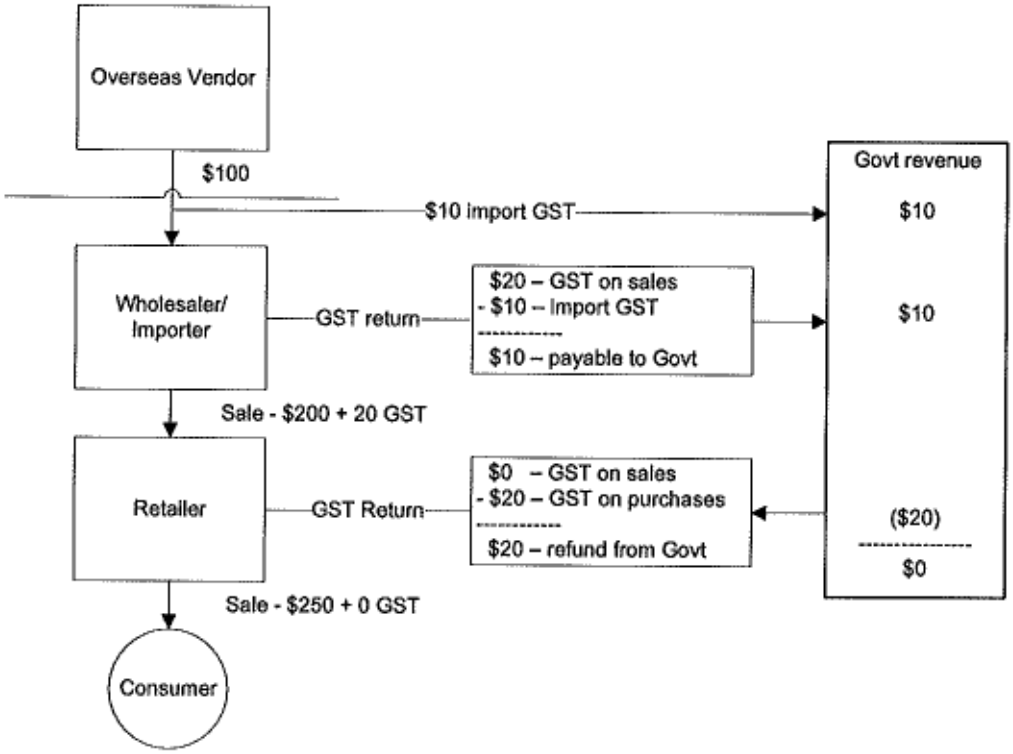
[95] PRIRC § 4020.08.

[96] New Zealand GST Act, § 12(2).

[97] Singapore GST Act . § 18, Malaysia GST Act, § 16, IMF Model Law, § 14, Irish VAT Act, § 54.

Zero-rating has the following impact on the supply chain and the collection of the tax:



A few countries zero rate some domestic supplies for social and political reasons: sales of food, medicines, books, children clothes and shoes (UK, Ireland) to completely remove the tax burden from the supply chain. This is widely viewed as inappropriate, because it amounts to a subsidy of the activity or transaction treated in this way and zero-rating is costly in terms of government revenue forgone as tax is relieved from the entire supply chain. It would usually be better to identify the policy reason for the subsidy and address it through a direct subsidy.[98]

Leading Practice

Zero-rating should be limited to exported goods and services where the effective consumption takes place outside of the GST jurisdiction, maintaining the destination principle of GST. As such, to the extent the services supplied to non-residents relate to real or moveable personal property in Puerto Rico, GST should be charged.

For the reasons explained under 3.A.1 supplies to the U.S. Federal Government and its instrumentalities should also be zero-rated.

In addition, to avoid double taxation in respect of fuel and hotel rooms and an additional tax burden being placed on consumers, given those supplies are subject to excise tax and the excise tax is unable to be adjusted due to debt obligations, such supplies should be zero-rated.

[98] David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996, p. 52.

Discussion

New Zealand zero-rates the following goods:[99]

- Exported goods;
- Duty free goods for travelers;
- Supply of a boat or aircraft leaving New Zealand under its own power;
- Goods not situated in New Zealand at the time of supply and the goods are subsequently imported by the recipient and subject to import GST;
- Goods used for the provision of zero-rated repair, renovation, modification services and those goods are consumed or affixed to the goods that are the subject of the zero-rated repair, renovation, modification services (e.g., good used in the repair of ships or aircraft temporarily in New Zealand);
- Goods for the use on a pleasure craft temporarily imported into New Zealand related to the operation of the craft;
- Consumable stores supplied for use on ships or aircraft leaving New Zealand;
- Sale of a taxable activity;
- Supply of land for the use in a taxable activity;
- Supply of any new fine metal after its refining; and
- Supply of tools to a non-resident that are to be used in New Zealand for the purpose of manufacturing goods solely for export.

Various rules are listed that restrict the application of zero-rating in certain circumstances to mitigate evasion opportunities.

New Zealand zero-rates the following types of services:[100]

- International transport of passengers or goods, including ancillary services such as the loading and unloading of goods, insurance related to such transport;
- Services supplied directly in connection with land or moveable personal property situated outside New Zealand;
- Services supplied to overseas postal organizations for the delivery of mail in New Zealand which originated from overseas;
- Services supplied directly in connection with temporarily imported goods;
- Services physically performed outside New Zealand or the arranging of services physically performed outside New Zealand;

[99] New Zealand GST Act, § 11.
[100] New Zealand GST Act, § 11A.

- Services supplied to a non-resident who is outside New Zealand at the time the services are performed and the services are not supplied directly in connection with land or moveable personal property in New Zealand;
- Supply of information to a non-resident where the services are supplied directly in connection with moveable personal property in New Zealand;
- Services supplied to a non-resident which are directly in connection with goods to be exported;
- Services supplied to a non-resident which are directly in connection with tools that are to be used solely to produce goods to be exported;
- Services related to imported goods under warranty to the extent the services are provided under the warranty and supplied to a warrantor who is a non-resident; and
- Certain telecommunication services supplied to a non-resident telecommunications supplier.

Singapore zero-rates the following types of goods:[101]

- Exported goods;
- Use as stores or fuel on aircraft or ship (including retail as merchandise to persons carried on a ship or aircraft);
- For installation on a ship or ship under construction;
- For use in the maintenance or operation of a ship;
- Supply of tools to a non-resident that are to be used in Singapore for the purpose of manufacturing goods for that non-resident; and
- Certain supplies to approved marine customers.

Singapore zero-rates international services which include the following:[102]

- International transport of passengers or goods, including ancillary services such as the loading and unloading of goods, insurance related to such transport;
- The letting on hire of any means of transport for use in a place outside Singapore which is exported by the lessor to such a place or are outside Singapore;
- Services supplied directly in connection with land or goods situated outside Singapore;
- Services supplied to a non-resident which are directly in connection with goods to be exported;
- Prescribed financial services supplied in connection with goods for export outside Singapore or for the removal of goods from a place outside Singapore to another place outside Singapore;

[101] Singapore GST Act, § 21(6), (6A).
[102] Singapore GST Act, § 21.

- Cultural, artistic, sporting, educational, entertainment, exhibition, convention (and ancillary services) wholly performed outside Singapore;
- Services supplied to a person who belongs outside Singapore and which directly benefit a person who belongs outside Singapore at the time the services are performed including computer server co-location services relating to equipment owned by the non-resident;
- Services supplied in connection with the handling of ships or aircraft, the handling or storage of goods carried on any ship or aircraft;
- Pilot age, salvage; or towage services performed in relation to ships or aircraft;
- Services comprising the surveying of any ship or aircraft;
- The supply of any ship or aircraft and certain parts;
- Prescribed services comprising the repair, maintenance or broking or management of any ship or aircraft;
- Prescribed services relation to telecommunication;
- Services supplied to a trust where the services and the person supplying the service satisfy the conditions as may be prescribed;
- Prescribed services in connection with the provision of an electronic system relating to the import or goods or export of goods out of Singapore;
- Supply of advertising services where the advertising is substantially made outside Singapore;
- Air and sea containers and certain services related to air and sea containers;
- Services supplied to a non-resident which are directly in connection with tools that are to be used solely to produce goods to be exported; and
- Grant or assignment of lease, tenancy or license to occupy land where the supply is to a non-resident and it is an approved warehouse.

The IMF Model Law is very similar to the New Zealand zero-rating provisions.

Ireland zero-rates an extensive list of goods including the following:[103]

- Export of goods;
- Certain food items;
- Books;
- Medicines and certain medical equipment; and
- Children's' clothing.

VAT relief for exported services, as found in the other jurisdictions, is addressed through the place of supply rules, treating the supplies as outside of the scope of Irish VAT to maintain the

[103] Irish VAT Act, Schedule 2.

destination principle rather than treating as within the scope of VAT and zero-rating the transaction (see section 3.B.2).

At the time of drafting, the Malaysian regulations governing zero-rating were only available in the local language.

The above lists are not exhaustive but are the principal and most relevant supplies that are zero-rated.

Zero-rating should be limited to exported goods and services where a local consumption tax should not be imposed on foreign purchasers where the effective consumption takes place outside of the GST jurisdiction, maintaining the destination principle of GST. Please refer to section 4.2.2.4 in the deliverable entitled *Analysis of Current Structure and Optional Tax Strategies* (Sept. 9, 2014) and Appendix E for the policy discussion around the implementation of multiple rates or exemptions in a GST regime and why a broad based system is preferred.

The described leading practice GST constitutes one of the biggest changes from the current applicable SUT regime, which provides a vast list of exempt transactions.[104] However, when addressing concerns of reducing existing exemptions and thus effectively broadening the scope of the GST, the following points should be reminded:

- Certain key exemptions remain under the leading practice GST in the form of GST exemptions (see section 3.B.9);
- Business inputs will be relieved based on the input tax credit system (see section 3.D.5);
- The regressivity resulting from eliminating key exemptions may be addressed via other means (see section 4.2.2.4 in the deliverable entitled *Analysis of Current Structure and Optional Tax Strategies* (Sept. 9, 2014));
- Export transactions will remain untaxed as explained above; and
- Key import transactions remain untaxed under special import provisions (see section 3.B.6).

3.B.9 Exempt Supplies

Overview of Concept

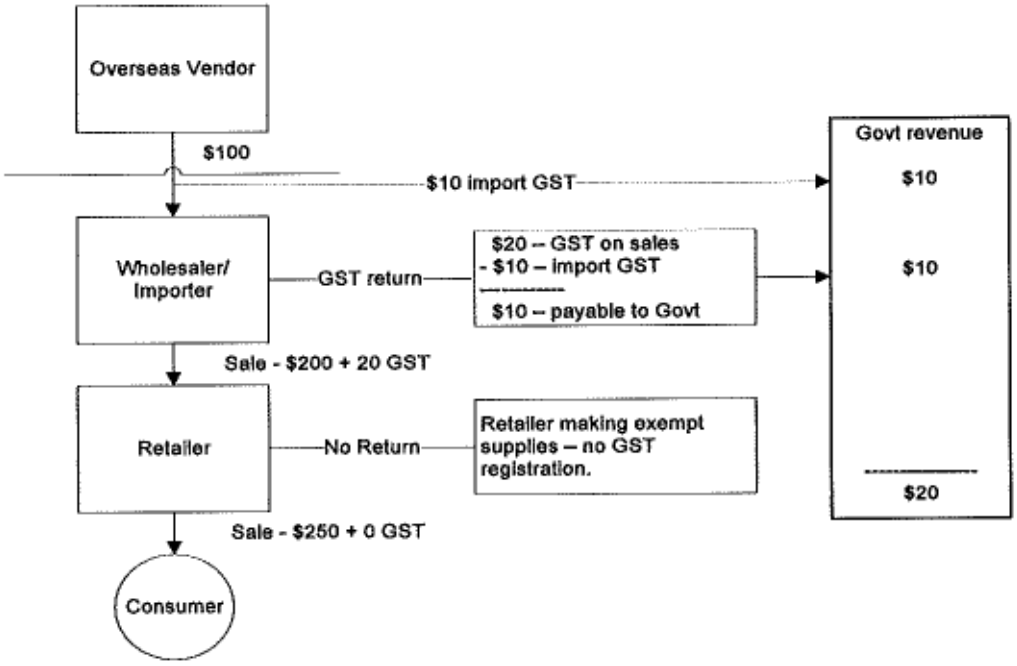
Where a supply of a good or service is exempt from GST, no GST is charged on the sale or provision of that good or service. However, the person making that supply is unable to recover the GST it has incurred on its purchases related to the making of that exempt supply (contrast this with zero-rating above).

Exemptions are usually implemented for social reasons (e.g., healthcare and education) or because they are difficult to tax (e.g., financial services). Please refer to section 4.2.2.4 in the deliverable entitled *Analysis of Current Structure and Optional Tax Strategies* (Sept. 9, 2014) and

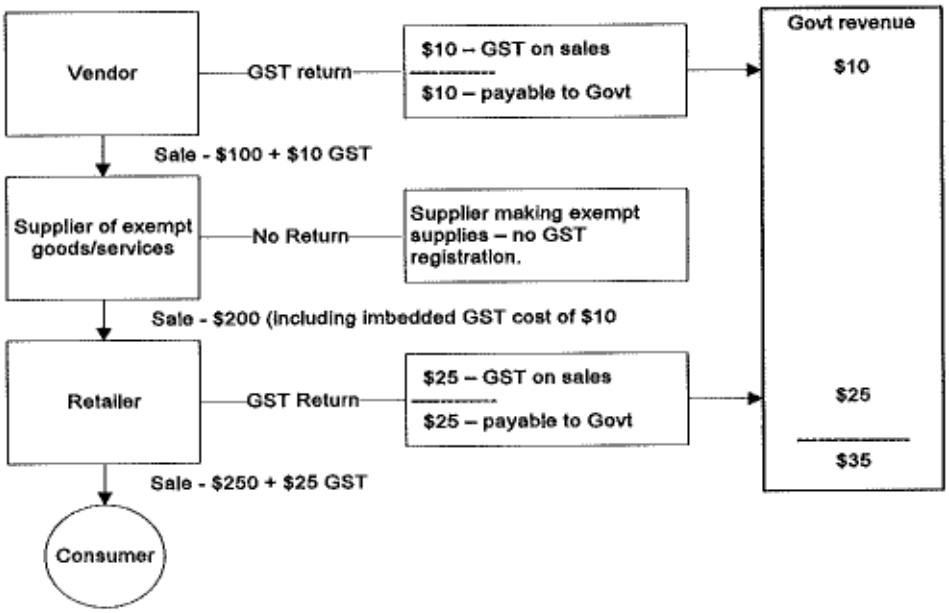
[104] PRIRC § 4030.01 to PRIRC § 4030.21.

Appendix E for the policy discussion around the implementation of multiple rates or exemptions in a GST regime and why a broad based system is preferred.

Exemptions have the following impact on the supply chain and the collection of the tax:



Where an exempt supply occurs further up the supply chain, tax cascading can occur, resulting in a higher effective tax rate at the end of the supply chain or creating incentives for vertical integration. Tax cascades arise when a supplier of exempt goods or services cannot recover the GST incurred on its purchases. That GST then becomes part of the cost of providing the services or producing the goods. Where a business that makes taxable supplies acquires these goods or services with this imbedded GST, and then charges GST on its supplies, there is effectively a tax on tax resulting in a higher effective tax rate. See diagram below:



In the above example, the tax rate is 10%. However, the effective tax rate is 14%.

Further challenges with exemptions include:

- Suppliers making exempt supplies can have an incentive to self supply or vertically integrate as GST charged by third parties is not recoverable;
- Entities making taxable and exempt supplies are required to track and apportion the GST charged on business inputs to ensure only GST related to taxable supplies that entity makes is recovered gives rise to higher compliance costs. This is difficult to achieve accurately and disputes can arise between the taxpayers and tax authority regarding the methods used to apportion input tax credits;
- Provides the opportunity for exemption creep due to political pressures from related industries that may not be subject to the exemption; and
- There are often issues with defining what should come within the scope of the exemption and what should not be included the interpretation of those definitions.

Exemptions should be carefully considered from a policy perspective and what they are intended to achieve. Ebrill et al[105] state "Exemptions are abhorrent to both the logic and the function of a VAT" as they narrow the tax base, result in taxation of business inputs, distort business decisions, and result in tax cascades.

However, should no other options be available to reduce the regressivity of a VAT, exemption is a better option, economically and administratively, than zero rating or reduced rates for the goods and services that require for some tax concession. Exemptions can be less costly to the government in terms of revenue generation as those businesses making exempt supplies are still being taxed on their inputs. Further, exemption is simpler than the reduced rate alternative, and politically, it is an easier sell to the general public.[106]

That said, exempting financial services and real estate are generally considered unavoidable. These areas are discussed below.

Financial Services

Financial services transactions generally include the provision of loans, taking of deposits, and trading in securities (e.g., shares) among other related services.

Financial services are almost universally exempt under GST systems around the world due to the challenges associated with identifying the base upon which the tax should be levied – the value of financial intermediation is usually included in the interest rate spread and is difficult to determine on a transaction by transaction basis. Extracting the value of the service element from this spread is problematic. Aside from the valuation issues, GST is generally a tax on consumption of goods and services whereas returns on savings are to compensate for the time value of money

[105] Ebrill et al, *The Modern VAT*, International Monetary Fund, 2001.
[106] Tuan Minh Le, *Value Added Taxation: Mechanisms, Design and Policy Issues*, May 2003.

and therefore should not be included in the consumption tax base until those savings are applied to purchases of goods or services. The taxation of the time value of money would effectively result in double taxation. In order to preserve the neutrality of a GST, there should not be a difference in the treatment of current versus deferred expenditure.

Such challenges do not exist where there are specific fees or commissions charged for services such as safe keeping services, debt collection, investment advisory services, etc. and these are generally treated as subject to GST. The problem becomes apparent with deposit and loan type transactions.

A number of options for the taxation of financial services to tax the margin of a financial intermediary (without taxing pure interest) and to eliminate the tax cascading effects have been considered around the world, including the Cash-Flow Approach,[107] addition method (tax on wages and profits),[108] zero-rating of B2B financial services,[109] and allowing financial intermediaries to claim input tax credits on a prescribed recovery percentage.[110]

The discussion of such options for taxation are beyond the scope of this paper as the complexities associated with such regimes for the taxation of financial services would create significant challenges with the implementation of a GST in Puerto Rico.

Although exempting financial services will depart from the objective of implementing a broad based GST system in Puerto Rico, such an exemption is current leading practice from a GST perspective.

Exported financial services should be zero-rated consistent with international practice and to ensure that Puerto Rican financial service industry is not competitively disadvantaged.

Real Estate

The application of GST to the real estate sector needs to be considered in the context of the following:

- Residential real estate;
- Commercial real estate; and
- Construction.

Nearly all jurisdictions exempt the renting or leasing of residential real estate. However, some choose to tax the sale of new residential real estate.

It is sometimes asserted that residential housing should be treated favorably because it is an essential part of household consumption and that favorable treatment would address the

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[107] Poddar & English, *Taxation of Financial Services Under a Value – Added Tax: Applying the Cash-Flow Approach,* National Tax Journal, Vol 50 No.1 (March 1997) pp. 89-112.

[108] Historic Israeli VAT treatment of financial services.

[109] New Zealand GST treatment of financial services.

[110] Singapore GST treatment of financial services.

regressivity issues that would otherwise arise if residential housing is subject to GST.[111] From a practical standpoint, the exemption of residential housing is generally driven by the fact that the taxation of owner-occupied housing is inherently challenging with a requirement to calculate an imputed rental value, not to mention the compliance/administrative burden perspective with all owner-occupiers being required to register and account for GST. While rental and leasing contracts are easier to tax as they are traded in the marketplace and therefore the taxable base is easy to determine, a difference in the GST treatment between owner- occupied housing and residential rental or leasing will distort consumers choices between buying a renting. Thus, residential real estate is generally exempt.

The treatment of commercial real estate varies from being exempt, taxable or exempt with the option to tax.

The treatment of construction services materials also varies in some jurisdictions depending on what the construction services relate to or the types of materials. This can cause significant compliance and administrative issues from a definitional perspective.

Leading Practice

The following supplies should be treated as exempt from GST:

- Financial services (other than zero-rated financial services);
- Supply by any non-profit body of any donated goods and services;
- The supply of residential accommodation by way of lease or otherwise;
- Supply of any fine metal (other than a supply of fine metal that is zero-rated);
- Supply of water and electricity.

Discussion

New Zealand exempts the following supplies:[112]

- Financial services (other than zero-rated financial services);
- Supply by any non-profit body of any donated goods and services;
- The supply of residential accommodation by way of lease or otherwise; and
- Supply of any fine metal (other than a supply of fine metal that is zero-rated).

Singapore exempts the following supplies:[113]

- Financial services;
- Investment precious metals; and
- Residential property.

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[111] Alan A. Tait, *Value Added Tax - International Practice and Problems*, International Monetary Fund, 1988, p. 61.
[112] New Zealand GST Act § 14.
[113] Singapore GST Act § 22, Fouth SCh, Part 1.

The IMF Model Law exempts the following supplies:[114]

- Financial services;
- Prescription drugs and medical services;
- Education services;
- Accommodation in a dwelling; and
- Supply of goods or services by the State or not for profit where the consideration for the goods and services is nominal in amount or not intended to recover the cost of such goods or services.

Ireland has an extensive list of exemptions that include the following:[115]

- Financial services;
- Welfare;
- Insurance;
- Education and training;
- Betting and lotteries;
- Medical Services;
- Postal services; and
- Letting of immovable property.

At the time of drafting, the Malaysian regulations governing exemptions were only available in the local language.

To facilitate the implementation of a leading practice GST system with a broad base and limited exemptions, leading practice would be to exempt the following services:

- Financial services (other than zero-rated financial services) – as discussed above, the exemption should be limited to financial services that are not based on a specific fees or commission;
- Supply by any non-profit body of any donated goods and services – because these goods or services likely contain an imbedded GST cost;
- The supply of residential accommodation by way of lease or otherwise; and
- Supply of any fine metal (other than a supply of fine metal that is zero-rated) – investment metals are generally considered a form a financial services.

The treatment of water and electricity is a special case in Puerto Rico. The pre-tax cost of both of these commodities is already extremely high and subjecting them to an additional GST tax would impose unacceptable additional costs on consumers. As such, a full taxation model may

[114] IMF Model Law, § 16, SCh. II.
[115] Irish VAT Act, schedule 1.

not be appropriate in Puerto Rico in respect of these sectors. As both are supplied by government authorities and are not in competition with the private sector, such an approach is manageable.

Regressivity issues associated with a GST in respect of basic food items, healthcare, and education for consideration should be dealt with via transfer payments. We refer to Appendix E for the policy discussion around the implementation of multiple rates or exemptions in a GST regime, why a broad based system is preferred, and exemptions relating to basic food items, education, and health care should be avoided.

3.C Registration

3.C.1 Registration

Overview of Concept

GST registration is similar to the current requirement for merchants to register in the Merchants' Registry.[116] Many jurisdictions set a monetary annual gross receipts threshold, whereby businesses that fall under this threshold do not need to register for GST. This not only means that those businesses are relieved from the obligation to collect and remit GST to the government but those businesses are also unable to claim credits for GST incurred on their business inputs.

The registration threshold will affect the revenue base of the tax (i.e., a higher registration threshold will result in fewer registered taxpayers).

GST registration thresholds vary widely from jurisdiction to jurisdiction. Thresholds vary partly as a reflection of the economic structure of a country. Some countries have a comparatively greater number of small businesses involving one person or one family than other countries. These small businesses or self-employed individuals will contribute little to the collection of GST. It is also administratively difficult—and therefore expensive—to collect tax from such people.[117] Further, GST compliance costs tend to be regressive (i.e., small businesses tend to spend proportionally more on compliance than larger businesses). The setting of a high threshold mitigates some of these issues.

Another advantage of setting a higher threshold, particularly at the introduction of the tax, is that there is less of a strain put on limited administrative resources during a time when there is limited taxpayer knowledge of the tax.

Overall, the main reason for excluding small businesses by setting a registration threshold is that the costs of tax administration and taxpayer compliance are disproportionate to the GST revenues generated from the activity of those businesses. The level of the threshold is generally a trade-off between minimizing compliance and administration costs and losing GST revenue.[118]

Setting the registration threshold is an important decision. The first VAT in Ghana failed, in part, due to the registration threshold being set too low. The second, and successful, implementation VAT in Ghana, avoided this problem by setting a higher threshold for the retail sector. In 1999 the

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[116] PRIRC § 4060.01.

[117] David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996, p. 15.

[118] OCED (2012), *Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administrative Issues*, OECD Publishing, p. 76.

threshold registration rate for the VAT was 200 million cedi ($80,000), up from 25 million cedi ($15,000) in 1995.[119]

Some countries have different registration thresholds for suppliers of goods and suppliers of services (e.g., France) and many others allow voluntary registration for businesses falling below the registration threshold. Further some jurisdictions have different registration thresholds for residents versus non-residents.

In summary, the advantages of adopting a low registration threshold includes:

- No artificial discrimination between taxpayers based on a threshold level;
- It enables to collect revenues at full potential; and
- There is no possibility to avoid taxation by artificially splitting of businesses.

However, as noted, this can give rise to a higher compliance burden on small businesses when introducing a new tax and a higher compliance cost for small businesses and tax administration that is disproportionate to the GST revenues.

The advantages of allowing voluntary registration for businesses falling below the registration threshold include:

- Enabling small businesses to recover GST on their inputs, potentially allowing them to become more competitive by reducing the price point of their goods or services without affecting their profit margin;
- Small businesses exporting goods will be able to recover GST on their inputs ensuring there is no embedded GST cascading through the system and indirectly imposed on foreign customers; and
- It can help avoid any distortionary effects arising from businesses operating just below the threshold.[120]

However, a voluntary registration program is not without its challenges. It can result in an increased burden on the tax administration arising from a higher number of registered taxpayer to manage and give rise to uncertainty in respect of the potential number of voluntary registrants on implementation, thus making resource planning difficult.

Leading Practice

During the implementation stage, a relatively high registration threshold should be set to limit the number of GST registered businesses to a manageable number. There is anecdotal evidence that upon the implementation of the IVU in Puerto Rico, the number of taxpayers that would register was grossly underestimated, which put a significant strain on Hacienda. A high registration threshold would help avoid this issue.

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[119] *Introducing a value added tax: lessons from Ghana*, The World Bank, PREM Notes – Public Sector, December 2001 Number 61.
[120] Ebrill et al, *The Modern VAT*, International Monetary Fund, 2001.

The registration threshold should be gradually reduced, as required over the two years following the implementation of the GST to the optimal level for Puerto Rico. This would enable a gradual implementation of GST and ensure that businesses and consumers get progressively used to the new tax.

Voluntary registration should be permitted and anti-avoidance provisions should be introduced to avoid artificial splitting of businesses to avoid GST registration obligations. Safeguards should be put in place to ensure those taxable persons voluntarily registering for GST are carrying on bona fide taxable activities. A requirement, similar to Singapore's, that if a business voluntarily registers it must remain registered for a certain period, may help deter frivolous registrations.

There should be no difference in the threshold level between suppliers of goods or services to promote simplicity and there should be no different in treatment between resident and non-resident taxpayers to promote neutrality.

Finally, the registration threshold calculation should exclude exempt supplies.

Discussion

New Zealand requires any person carrying on a taxable activity to register for GST at the end of any month where the total value of their supplies made in New Zealand exceeds NZ$60,000 in that month and the previous 11 months or is expected to exceed that amount in the next 11 months.[121] Exceptions are provided where there is no expectation that the supplies will exceed that amount in the following 12 months or where the exceeding of the threshold was due to the ending or substantial reduction in size of the taxable activity, or the replacement of any plant or capital asset.

Where a person does become liable, that person is required to apply for registration within 21 days.

Voluntary registration is possible where a person is carrying on, or intends to carry on, a taxable activity but has not breached the registration threshold and any person purporting to charge tax on a supply is also deemed to be a registered person.

New Zealand also allows the registration of non-residents where that person would be eligible to register if carrying on its business in New Zealand for the purposes of input tax recovery.[122]

Singapore takes a similar approach to New Zealand but refers to quarters rather than months and the annual threshold is SG$1 million. Singapore also includes a provision that prevents the artificial splitting of taxable activities such that a taxable person falls below the registration threshold.

[121] New Zealand GST Act, § 51.
[122] New Zealand GST Act § 54B.

Where a person becomes liable to be registered in Singapore, that person is required to apply for registration within 30 days.

As with New Zealand, a person can voluntarily register for GST in Singapore. However, where a person voluntarily registers for GST in Singapore, that person must remain registered for at least two years.

Malaysia is similar to Singapore and New Zealand.[123] However, imported services are excluded from the turnover threshold calculation. The registration threshold is RM500,000 and where a person becomes liable to be registered in Malaysia, the person must apply for registration within 28 days. Voluntary registration is also permissible. Malaysia also contains a rule to prevent the artificial splitting of businesses to avoid breaching the turnover threshold.

The IMF is also similar. However, the law includes specific rules for auctioneers, promoters of public entertainment and the display of registration certificates.[124]

Ireland is similar. However a different threshold applies for those businesses supplying goods as opposed to services (EUR75,000 and EUR37,500 respectively) and there is no threshold for non-residents making supplies in Ireland.

The threshold calculation in all cases excludes exempt supplies. Jurisdictions achieve this through various mechanisms (e.g., excluding exempt supplies from the definition of taxable activity or using the term taxable supplies for calculating the registration threshold).

In most cases, the value of imported services is included in the calculation of the registration threshold. However, Malaysia requires businesses to account for imported services even where businesses are not registered, while most other jurisdictions only require registered businesses to account for the reverse charge on imported services.

3.C.2 Cessation of requirement to be registered and cancellation of registration

Overview of Concept

It is important to determine when a taxable person ceases to be required to be registered and the consequences of that deregistration.

Leading Practice

Deregistration should be permitted where the tax authority is satisfied that the taxable person's value of taxable supplies is, or is not expected to exceed the turnover threshold, or where the taxable person ceases carrying on a taxable activity.

Rules should be included to deem goods on hand at the time of registration to be supplied and GST should be accounted on the lesser of cost or open market value of those assets.

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[123] Malaysia GST Act, §s 19 to 24.

[124] IMF Model Law, § 20 and 21.

Retrospective deregistration should be provided for where a person has been registered in error.

Discussion

New Zealand deems a person to cease being liable to be registered where at any time the Commissioner is satisfied that the value of that persons taxable supplies in the next 12 months will be below the registration threshold. A person that satisfies this requirement may cancel the registration effective on the last day of the taxable period in which the Commissioner was satisfied.[125]

A person that ceases carrying on all taxable activities must notify the commissioner within 21 days.

The commissioner may also cancel the registration where he is satisfied that the person is not carrying on a taxable activity.

The Singapore, Malaysian and IMF cancellation rules are similar to New Zealand's. However, for Singapore and Malaysia the notification period is 30 days rather than 21 days.

A key aspect of deregistration applicable to all jurisdictions is that the assets on hand upon deregistration are deemed to be supplied at the time of deregistration. Jurisdictions often include this rule in the definition of supply (with associated valuation and time of supply rules). The valuation rules can require the deemed supply to be accounted for on the lesser of open market value or the original cost of the asset or simply the open market value.

Ireland has similar deregistration rules,[126] but, it does not deem goods on hand at deregistration to be supplied. Instead it requires an adjustment to the previous input tax claimed. Such a provision is more complex to administer than the deemed supply rules adopted by the other jurisdictions. As such, deregistration rules similar to New Zealand, Singapore, Malaysia and the IMF constitute leading practice.

3.D Calculation of Tax Payable, Tax Periods, and Tax Returns

3.D.1 Taxable periods

Overview of Concept

The taxable period is the period of time in respect of which a return is required to be filed to report the tax position of a taxable person. Consequently, the taxable period is closely related the payment and refund of GST. The length of the taxable period is generally a policy decision that needs to be made taking into account administration and compliance burdens and cash flow issues. The approach of jurisdictions varies from monthly, bi-monthly, quarterly, or annual taxable periods.

[125] New Zealand GST Law § 52.

[126] Irish VAT Act, § 65 and Regulation 19(3).

Leading Practice

The taxable period provision should be drafted to include the following:

- The taxable period for taxable persons whose taxable supplies over a consecutive 12 months period are equal or above a certain dollar value threshold shall be the calendar month.
- The taxable period for taxable persons whose taxable supplies over a consecutive 12 months period are below the dollar value threshold shall be the calendar quarter.
- Taxable persons subject to the calendar quarter taxable period should be allowed to apply for authorization to use the calendar month as taxable period.

Discussion

New Zealand allows monthly, two-monthly, and six monthly periods. The 2-month period is the standard taxable period.[127] A taxable person may apply for the six monthly period where, in a 12-month period, the taxable person makes (or is likely to make) taxable supplies of less than NZD 500,000.[128]A person whose taxable supplies are (or are likely to be) more than NZD24 million in a 12-month period must adopt a monthly taxable period.[129]In all other cases, a person can choose between a monthly or bi-monthly taxable period. A person's taxable periods must align with their balance date for income tax purposes. The period will usually end at the end of the relevant calendar month.

Singapore requires the filing of GST returns every month, quarter, or half a year, or any frequency approved by the tax authority.[130] The default filing frequency is quarterly. Taxable persons are assigned prescribed accounting periods according to their financial year-end at the point of GST registration. Taxable persons may request a change in their filing frequency. However, filing of a return every half a year is available only to taxable persons whose annual value of taxable supplies is less than SGD1 million on a retrospective or prospective basis.

Malaysia allows two taxable periods: monthly and quarterly.[131] The monthly taxable period applies to taxable persons whose taxable supplies in a 12-month period are MYR 5 million or more. Taxable persons with annual taxable supplies of less than MYR 5 million are subject to the quarterly taxable period but can request to file monthly returns.

In the IMF Model Law, the taxable period is the calendar month, but the Minister may by regulations authorize different tax periods for specific types of taxable persons.[132]

Ireland has a two-monthly filing frequency, but smaller taxable persons may apply to adopt a four-monthly filing period where their annual liability is between EUR3,001 and EUR14,400. If a taxable person's annual liability is below EUR3,000, a taxable person can apply to file on a six-

[127] New Zealand GST Act, § 15(1).
[128] New Zealand GST Act, § 15(2).
[129] New Zealand GST Act, § 15(4).
[130] Singapore GST Act, § 41(1) and GST Regulations, regulation 52.
[131] Malaysia VAT Act, § 40.
[132] IMF Model Act, art. 23.

monthly basis.[133] A key difference between Ireland and the other comparable jurisdictions is that the thresholds for filing frequency focus on GST liability rather than gross receipts.

In order to ensure the efficiency and effectiveness of the GST, the taxable period should be short. A common approach is to use a calendar month taxable period. The monthly taxable period is also used under the current sales and use tax regime and will thus not result in a change for businesses.[134] However, because a shorter taxable period could increase the administrative burden on small businesses compared to revenues collected it is advisable to allow smaller taxable persons to adopt longer taxable periods such as two-monthly or calendar quarter.

The difference between taxable persons subject to the monthly and quarterly taxable period should be determined based on the value of taxable supplies made over a 12 months period. Consequently, the monthly taxable period would apply to taxable persons who estimate that over the next 12 months their taxable supplies will be above a certain dollar value threshold. The quarterly taxable period would thus apply to those taxable persons with taxable supplies below the threshold. In addition, taxable persons subject to the quarterly taxable period should be allowed to file a request to the Commissioner to be allowed to be subject to the monthly taxable period.

An alternative option to alleviate cash flow burdens on the tax administration would be to adopt a similar approach as Ireland, basing the taxable period on net VAT liability, but making the longer taxable periods mandatory rather than optional for those taxable persons frequently in a refund position. Such an approach is not leading practice and can result in significant cash flow burdens on taxpayers such as exporters.

3.D.2 Filing of returns and payment of the tax

Overview of Concept

Under a GST, taxable persons are required to provide information to the tax authority at regular intervals. The information is provided through the filing of a "GST return." The GST law or regulations should precisely describe what information taxable persons must provide and the deadline for filing GST returns. In addition, GST laws generally prescribe when payment of the tax is due.

The main consideration relates to providing sufficient time following the end of the taxable period to gather the required information and calculate the GST liability.

Leading Practice

The filing of returns and payment of tax provision should be drafted to include the following:

- Every taxable person should be required to file a GST return and pay any GST by the 28th of the month following the end of the taxable period.

[133] Irish VAT Act, § 76 and 77.
[134] PRIRC § 4041.02.

- GST return should be submitted electronically.

The provision or regulation should also set out what information is required to be included in the GST return.

Discussion

New Zealand requires taxable persons to file their GST returns on or before the 28th day of the month following the end of the taxable period unless the month following the end of the taxable period is December, in which case the deadline is January 15, or April, for which the deadline is May 7.[135] This is to provide the taxable person with extra time given the December holidays and the March end of financial year obligations. The tax authority has the discretion to change the due date for the return for non-profits and in special circumstances.[136] GST returns can either be filed in paper or electronic format.

In Singapore, returns (and payments) are due within one month of the end of the prescribed accounting periods; e.g., for the prescribed accounting period from January to March, ending on March 31, the filing (and payment) due date is April 30. The due date for the prescribed accounting period from April to June, ending on June 30, is July 31, and so on.[137] Returns must be filed electronically[138].

In Malaysia, every return for each taxable period is required to be submitted to the tax authority no later than the last day of the month following the end of the taxable period.[139] Electronic filing is encouraged but not mandatory.

In the IMF Model Law, taxable persons are required to file a tax return for each tax period with the Commission within 21 days after the end of the period, whether or not tax is payable in respect of that period.[140] The return should be filed in the manner prescribed by the Commissioner.

Ireland requires a return to be filed within 19 days of the end of the taxable period.[141]

In all jurisdictions, the deadline for payment of VAT/GST is the same as the deadline for the filing of the return. All jurisdictions reviewed, other than Ireland, have a deadline close to, or at, the end of the month following the end of the taxable period.

3.D.3 Accounting Basis

Overview of Concept

GST laws generally have two distinct methods of accounting: accruals (or invoice) and cash (or payments) accounting. Most jurisdictions adopt the accrual basis of accounting. Any supplies in

[135] New Zealand GST Act, § 16.
[136] New Zealand GST Act, § 16(3).
[137] Singapore GST Act, § 41(1) and GST Regulations, regulation 52.
[138] Singapore GST Act, § 42 and GST Regulations, regulation 53.
[139] Malaysia GST Law, § 41(4).
[140] IMF Model Law, art. 24(1).
[141] Irish VAT Act§ 76.

respect of which the time of supply has been triggered within the taxable should be included in the tax return, irrespective of payment. Cash accounting, or payments basis accounting, requires only those supplies in respect of which payments have been made or received within the taxable period to be accounted for in the tax return. In addition, because GST is only accounted for when payment is received, there is no need for a bad debt relief mechanism (see section 3.D.7). However, the cash accounting system delays the moment when GST is creditable to the time when vendors are paid.

Leading Practice

The accounting basis provision should be drafted to include the following:

- All taxable persons must account for GST according to the accrual basis.
- Taxable persons whose taxable supplies over a consecutive 12 months period are below a certain dollar value threshold may opt to account for GST under a cash basis.

Discussion

The NZ GST Act provides three types of accounting methods: the invoice (or accruals) basis, the payments (or cash) basis, and the hybrid basis.[142] The invoice basis is the default method.

The payments basis is mandatory for non-residents who are registered solely for the recovery of input tax, and resident non-profit entities. Any other taxable person that makes taxable supplies of NZD 2 million or less within any 12 month period may request to be on a payments basis.[143]

New Zealand also has a hybrid basis (essentially a combination of payments and invoice basis) where, the registered person must account for output tax on an invoice basis, but claim input tax credits for purchases and expenses using the payments basis.

Singapore requires all taxable persons to account for output and input tax in line with the time of supply rules (accruals basis). In addition, taxable persons whose annual taxable supplies do not exceed SGD 1 million can opt to account for VAT on a cash basis.[144]

The Malaysian GST Act also requires all taxable persons to account for GST on an accrual basis.[145] However, the Director General may, upon application in writing and subject to the prescribed conditions, approve the registered person to account for the tax on a payment basis.

The IMF Model Law does not contain any specific provision regarding the accounting basis. Therefore, output and input VAT must be accounted in line with the time of supply rules.

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[142] New Zealand GST Act, § 19.
[143] New Zealand GST Act, § 19A.
[144] Singapore GST Act, § 41 and GST Regulations, regulation 67 to 76.
[145] Malaysia VAT Act, § 37(1).

Ireland is similar to the above jurisdictions in that the accrual basis is the default accounting basis and payments basis is permitted if the taxable makes supplies less than EUR 1 million or it makes 90% or more of its supplies to non-registered persons.[146]

Leading practice is to have the accrual basis of accounting as the default accounting basis and to provide an option for cash accounting where a taxable person's turnover is less than a specified threshold.

3.D.4 Calculation of Tax Payable

Overview of Concept

GST payable for a particular taxable period should correspond to the output tax attributable to a taxable period less any input tax attributable to a taxable period, consistent with the accounting basis adopted by the taxable person. Including a provision relating to the calculation of tax payable provides clear guidance to the tax authority and taxable persons on how the tax liability or refund should be computed for any given tax return.

Leading Practice

The calculation of tax payable provision should be drafted to include the following:

- Tax payable for a taxable period by a taxable person under the GST law amounts to any output tax attributable to the taxable period less any input tax attributable to the taxable period, subject to the specific input tax deduction rules.
- Where during a taxable period the amount of deductible input tax exceeds the attributable amount of output tax, the excess input tax amount shall be refunded to the taxable person in accordance with the refund of excess tax rules.

This section should also state in which periods output tax and input tax are attributable.

Discussion

The New Zealand GST Act includes a tax calculation section that determines how the tax payable or refund for a particular taxable period should be calculated.[147]

The section states that the amount of tax payable corresponds to the amount of output tax accounted for in the taxable period less the amount of input tax deductible in the taxable period. Further, where the amount of input attributable to the period exceeds the amount of output attributable to the period, the amount is required to be refunded by the Commissioner.

New Zealand also includes input tax deductibility rules within this section. These are analyzed separately in section 3.D.5 below.

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[146] Irish VAT Act, § 80.

[147] New Zealand GST Act, § 20(1).

Ireland adopts a similar approach to New Zealand.[148]

Singapore takes a similar approach but includes the input tax deductibility rules in a separate section.[149] However, the tax calculation provision also details the apportionment and adjustment rules,[150] while in New Zealand these are addressed under a separate section.

Malaysia adopts a slightly different approach to the other jurisdictions. While it also has a single provision governing the computation of the tax position of the taxable person similar to Singapore,[151] it has separate provisions addressing what input tax may be deducted. Unlike Singapore and similar to New Zealand, the adjustment and apportionment rules are dealt with in a separate provision. In addition, Malaysia includes specific refund rules under this provision that govern when a refund is paid or when a refund should be carried forward or applied for another purpose.

For simplicity, leading practice would be to adopt an approach similar to the IMF,[152] which effectively is a combination of the approaches from all of the comparable jurisdictions. This includes having separate provisions for:

- The calculation of the tax liability;
- The input tax deductibility rules;
- The apportionment and adjustment rules; and
- The refund rules.

The separate provisions relating to input tax deductibility, apportionment and adjustments, refund rules are addressed below.

3.D.5 Input Tax Deductions/Credit Rules

Overview of Concept

Input tax is generally defined as any GST paid to a supplier. In principle, any input tax incurred by a taxable person should be deductible or creditable against any output tax liability provided the supplies are used in a taxable activity carried on by the taxable person. This deductibility feature of a GST facilitates the staged collection process of a GST while ensuring GST does not become an absolute cost to businesses and shifting the economic burden of the tax onto the consumer.

Specific rules are required to ensure the correct amount of input tax is deductible by a taxable person.

[148] Irish VAT Act, § 59(2).
[149] Singapore GST Act, § 19.
[150] Singapore GST Act, § 19(4).
[151] Malaysia GST Act, § 38.
[152] IMF Model Law, § 26.

Leading Practice

The input tax deductions/credit rules should be drafted to include the following:

- A taxable person should be allowed to deduct:
  - the total amount of input tax incurred on taxable supplies paid during a taxable period;
  - the total amount of input tax paid on imports of goods during a taxable period;
  - any amount allowed as additional input tax deduction under the adjustment, apportionment and bad debt rules;
  - Less any amount that is deemed output tax under the adjustment and apportionment rules.
- Input tax should only be deductible if the goods and services purchased are used by the taxable person for making taxable supplies or supplies that would be taxable if made in Puerto Rico.
- Deemed input tax credits for certain industries such as secondhand goods dealers and certain insurance company payouts.
- Input tax credits for goods and services acquired by government entities.
- Input tax credits for goods and services acquired by non-profit bodies for activities other than those related to exempt supplies.
- Input tax should only be deductible provided that the taxable person holds a valid tax invoice, credit, debit note, or import document.

To promote a broad based, neutral GST system there should be no categories of goods or services in respect of which input tax recovery is denied.

Discussion

New Zealand defines "input tax" as GST imposed on goods and services acquired by a person under the GST Act, GST imposed at import, and a tax fraction of the purchase price of second hand goods.[153]

In general, input tax can be deducted only to the extent to which the goods or services acquired are used for, or available for use in making taxable supplies,[154] which is determined at the time of acquisition. In addition to this general rule, New Zealand provides a number of specific rules for input tax deductions, including the following:

- Tax invoice, debit or credit note must be held (unless certain exceptions apply);
- Timing of input tax credits in respect of output tax accounted for under the reverse charge regime;
- Import GST;

[153] New Zealand GST Act, § 3A(1).
[154] New Zealand GST Act, § 20(3C).

- Input tax credits for goods and services acquired by charities;
- Insurance payments;
- Amounts calculated under the adjustment and apportionment rules;
- Bad debts; and
- Non-resident recovery.

In addition, input tax incurred in relation to entertainment expenses is only deductible to the extent permitted under the income tax law.

Singapore takes a more prescriptive approach, defining input tax more narrowly than most other jurisdictions. The definition of "input tax" does not include input tax incurred on supplies of goods or services to a taxable person and importations of goods by a taxable person, where the goods or services are not used or not to be used partly for the purposes of his business.[155] Further, rather than having a general rule that input tax is deductible to the extent the good or service are used in the taxable person's taxable activity, the GST Act states that taxable persons are entitled to credit input tax at the end of a prescribed accounting period to the extent that the input tax is attributable to the following supplies made or to be made by the taxable person in course of business:

- taxable supplies;
- supplies outside Singapore that would have been taxable supplies if made in Singapore;
- supplies of goods made while the goods are under customs control; and
- supplies made for which no output tax is chargeable under the various schemes in the GST Act.[156]

Input tax deduction is disallowed for GST paid on any of the following expenses: club subscription fees, medical and accident insurance premiums, medical expenses, family benefits, and any transaction involving betting, sweepstakes, lotteries, fruit machines, or games of chance.[157]

The tax authority may require that any claim for input tax credit to be supported by a tax invoice or import permit.[158]

Under the Malaysian GST Act, a taxable person is allowed to deduct input tax for GST incurred in the course of making taxable supplies and supplies made outside Malaysia, which would have been taxable if made in Malaysia.[159] In addition, for importation of goods, only GST which has actually been paid on importation can be claimed.

Input tax is only deductible where the following conditions are met:

- the claimant is a taxable person;
- the goods or services are acquired for business purpose;

[155] Singapore GST Act, § 19(4).
[156] Singapore GST Act, § 20.
[157] Singapore GST Regulations, regulation 25.
[158] Singapore GST Regulations, regulation 61.
[159] Malaysia GST Act, § 38.

- the goods are acquired for the purpose of making taxable supplies;
- there must be a valid tax invoice;
- the invoice is issued under the name of the claimant, and
- the goods and services acquired are not subject to any input tax restrictions.[160]

The GST Act denies an input tax deduction for GST incurred on certain types of expenses such as private motorcars and certain employee benefits.[161]

The IMF Model Law allows a taxable person to deduct input tax payable in respect of taxable supplies made to the person during the taxable period, and paid in respect on any import of goods by the person during the tax period, where the supply or import is for use in a taxable activity carried on by the person.[162]

The IMF law also clearly indicates that a taxable person is allowed an input tax deduction relating to input tax allocation and bad debts, and specific situations such as gambling and vouchers.[163]

An input tax deduction is only granted if the taxable person holds a tax invoice, tax debit or tax credit note, or a bill of entry for customs purposes.[164] However, the Commissioner may allow input tax deduction where an invoice is missing if the Commissioner is satisfied that (1) the taxable person took all reasonable steps to acquire a tax invoice, (2) the failure to acquire a tax invoice was not the fault of the taxable person, and (3) the input tax amount is correct.[165]

Taxable persons are not allowed to deduct input tax incurred in relation to the following purchases: passenger vehicles, entertainment, and fees or subscriptions paid for memberships.[166]

Ireland adopts a similar approach. However, Ireland has more restrictions in terms of what cannot be claimed as an input tax deduction, including:

- Limited deduction on purchase or hire of motor cars;
- Any business entertainment;
- Accommodation (except for qualifying hotel conferences);
- Food and drink;
- Petrol (VAT on diesel is claimable);
- Employee personal services (e.g., dry cleaning).[167]

Because input tax deduction is the cornerstone of any neutral, efficient, and fair GST law, special attention should be paid to the drafting of the input tax deduction/credit rules.

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[160] Malaysia, GST Guide for Input Tax Credit, at 33.
[161] Malaysia, GST Guide for Input Tax Credit, at 11.
[162] IMF Model Law, § 27(1)(a).
[163] IMF Model Law, § 27(1).
[164] IMF Model Law, § 27(2).
[165] IMF Model Law, § 27(3).
[166] IMF Model Law, § 28(2).
[167] Irish VAT Act, §§ 59-62.

All the comparable jurisdictions adopt a similar approach whereby input tax should be deductible on any input tax incurred or paid on imports that are used by the taxable person to carry out taxable supplies. Differences arise in respect of specific disallowances or specific deeming rules for claiming input tax credits (e.g., an insurance payout in New Zealand, the acquisition of secondhand goods, or goods and services acquired by charities).

The commonly adopted approach will ensure that input tax paid on private consumption is not deductible by the taxable person. As goods may be acquired either for business or private or use, it is advisable to address such situations under the adjustment and apportionment rules (see section 3.D.6).

Only input tax incurred during the taxable period should be recoverable under this provision. A specific provision under the adjustment and apportionment rules should address the case where a taxable person does not report input tax in the correct taxable period (see section 3.D.6). For clarity purposes, the input tax deduction provision should also clearly state that input tax calculated based on the adjustment and apportionment rules and the bad debt rules is also recoverable, but any output tax adjustment under the adjustment and apportionment rules should also be taken into consideration.

In order to prevent fraud, the provision should also state that input tax is only deductible provided that the taxable person holds a valid tax invoice, credit note, debit note or import document (see section 3.D.9).

Other than New Zealand, most of the comparable jurisdictions deny an input tax deduction for certain specific goods and services. Such an approach goes against the principles of neutrality, efficiency, and fairness as generally all expenses incurred by a taxable person for the purposes of the business should be considered creditable. As such, leading practice should be an approach similar to the New Zealand approach.

In Puerto Rico, to maintain the simplicity of the operation of the GST, supplies made to government bodies should be treated in the same manner as any other supply (i.e., subject to GST). However, in order to ensure that the GST does not impact the budget of a government body, such government bodies should be entitled to input tax credits in relation to their acquisitions regardless of their activity.

3.D.6 Adjustment and Apportionment Rules

Overview of Concept

The rules for allowing input tax deduction present few difficulties for taxable persons making exclusively taxable supplies. However, the GST law should address two issues. First, the GST law must address the situation where a taxable person makes both taxable and exempt supplies. Second, the GST law must address private or non-business use of goods and services.

Apportionment rules

Given that the premise for input tax recovery is that the taxable person uses the goods and services purchased to carry out taxable supplies, taxable persons making both taxable and exempt supplies should be entitled to a partial recovery of input tax to the extent the goods and services are applied to the taxable part of the taxable person's business. Consequently, the GST law must limit the right to deduct input tax to the extent the goods and services are applied to the making of exempt supplies.

This requires a careful review of the total input tax paid by a taxable person to apportion the input tax into three categories:

- Input tax exclusively incurred for making taxable supplies (fully recoverable);
- Input tax incurred for making exclusively exempt supplies (non-recoverable); and
- Input tax incurred for making both taxable and exempt supplies (partially recoverable).

The apportionment rules address the third category.

Adjustment rules

In addition to apportionment, adjustment rules are used to address situations such as follows:

- Goods and services acquired for use in the taxable activity but subsequently used for a non-business purpose;
- Goods acquired for a non-business purpose but subsequently used in a taxable activity; and
- Post sales adjustments to the purchase price, including discounts.

Leading Practice

The apportionment rules should be drafted to include the following:

- Where a taxable person carries out taxable and exempt supplies, input tax should be deductible as follows:
  - Input tax incurred exclusively to carry out taxable supplies should be fully deductible;
  - Input tax incurred exclusively to carry out exempt supplies should not be deductible; and
  - Any residual input tax should be deductible based on the following formula: residual input tax deductible = residual input tax * total taxable supplies (excluding GST) during taxable period / total supplies (excluding GST) during taxable period.
- The above rule should not apply where exempt supplies do not exceed a specified dollar value threshold in a month and a certain percentage threshold of the total value of total supplies made in that period.
- Supplies considered as incidental financial supplies should not be subject to the above rules.
- Where a taxable person is in the business of carrying out exempt supplies the incidental financial supplies rule should not apply.

The adjustment rules should be drafted to include the following:

- Where the use of goods and services of a certain dollar value threshold changes within a certain timeframe after the end of the taxable period, the taxable person is required to make the following adjustments:

- Any over-deducted input tax should be accounted for as output tax in the tax return for the taxable period in which the change of use takes place.
- Any short claimed input tax should be accounted for as additional input tax in the tax return for the taxable period in which the change of use takes place.

- An adjustment should not be required where the change of use of the goods and services purchased is below a certain percentage threshold.
- No adjustment should be required where the goods or services are lost or unintentionally destroyed.
- Where a registered person issues a credit note in accordance with the tax invoice, tax credit note, and tax debit note rules, the additional tax specified in the tax credit note is deemed to be output tax for the registered recipient of the credit note and additional input tax for the supplier.
- Where a registered person issues a debit note in accordance with the tax invoice, tax credit note, and tax debit note rules, the additional tax specified in the tax debit note is deemed to be input tax for the registered recipient of the debit note and additional output tax for the supplier.

In addition, the adjustment rule should also address the situation where a taxable person does not report input tax in the correct taxable period.

Discussion

Apportionment rules

New Zealand applies a minimum threshold for apportionment where goods and services are acquired for both the making of taxable and exempt supplies.[168]Under this provision, registered persons are not required to apportion a deduction for input tax if in an "adjustment period" (generally a 12-month period) they make both taxable and exempt supplies and have reasonable grounds to believe that the total value of their exempt supplies will not be more than the lesser of: NZD 90,000; and 5% of the total consideration for all their taxable and exempt supplies for the adjustment period. Above this threshold, apportionment is required, and is calculated by multiplying the full input tax deduction by the percentage intended use.[169]

"Percentage intended use" for a registered person, means the extent to which the goods or services are intended to be used by the person for making taxable supplies, estimated at the time of acquisition and expressed as a percentage of total use.[170] According to the New Zealand tax authority, the method for determining the extent of intended taxable use will largely depend on the nature of the goods and services in question (e.g., for a car the logbook of the previous car may be used). New Zealand has a number of specific rules relating to such thing as:

- Apportionment for suppliers of financial services; and

[168] New Zealand GST Act, § 20(3D).
[169] New Zealand GST Act, § 20(3H).
[170] New Zealand GST Act, § 21G(1)(b).

- Use of certain assets.

Singapore also applies a *de minimis* rule whereby, if during an accounting period the exempt supplies do not exceed both an average of SGD 40,000 per month and 5% of taxable and exempt supplies, no apportionment of input tax is required.[171] In addition, the Singapore GST Act provides that where a taxable person supplies incidental exempt supplies (e.g., deposit of money, exchange of currency, issue of own shares or debt securities, loan, assignment of trade derivatives, issue of units, and purchase of bonds) a taxable person is not required to apportion the input tax incurred.[172] This rule does not apply if the taxable person's main activity involves these transactions (e.g., financial institution).

Where the foregoing rules cannot be applied, input tax is deductible on supplies and imports that can be identified as used or to be used exclusively in making taxable supplies. Input tax paid on supplies and imports used exclusively in making exempt supplies or in carrying on any activity other than making taxable supplies is not deductible. Any input tax ("residual input tax") used for both taxable and exempt supplies must be apportioned according to use based on the following formula:[173]

> Residual input tax recoverable = residual input tax * value of taxable supplies / (value of taxable supplies + value of exempt supplies)

Like New Zealand and Singapore, Malaysia applies a *de minimis* rule when the total value of exempt supplies does not exceed an average of RM5,000 per month and does not exceed 5% of the total value of total supplies made in that period.[174]

Similar to Singapore, Malaysia also excludes from any apportionment obligation incidental financial supplies such as deposit of money, exchange of currency, holding of bonds, transfer of securities, loan, holding of any unit, and hedging.[175] These supplies will not be considered as incidental if the taxable person is considered to be in the business of making exempt supplies. The GST Act provides a list of persons falling in this category (e.g., banks, moneylenders, and credit card companies).

In Malaysia, where the foregoing rules cannot be applied, input tax on supplies and imports that can be identified as used or to be used exclusively in making taxable supplies is deductible. Input tax paid on supplies and imports used exclusively in making exempt supplies or in carrying any activity other than making taxable supplies is not deductible. Any input tax ("residual input tax") used for both taxable and exempt supplies must be apportioned according to use based on the following formula:[176]

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[171] Singapore GST Regulations, regulation 28.

[172] Singapore GST Regulations, regulation 33.

[173] *See e.g.*, Internal Revenue Authority Singapore, IRAS e-Tax Guide – GST: Partial Exemption and Input Tax Recovery (Dec. 31, 2013).

[174] Malaysia, GST Guide for Input Tax Credit, at 21.

[175] Malaysia, GST Guide for Input Tax Credit, at 17.

[176] Malaysia, GST Guide for Input Tax Credit, at 23.

Residual input tax recoverable = total value of taxable supplies (excluding GST) / total value of all supplies (excluding GST) * residual input GST

The IMF Model Law also provides for a *de minimis* rule that applies where the proportion of taxable supplies of total supplies (including exempt supplies) is more than 90% during the preceding financial year.[177] Unlike Malaysia and Singapore, the IMF Model Law does not address incidental exempt supplies. Where the *de minimis* rule does not apply, input tax on supplies and imports that can be identified as used or to be used exclusively in making taxable supplies is deductible. Input tax paid on supplies and imports used exclusively in making exempt supplies or in carrying any activity other than making taxable supplies is not deductible. Any input tax ("residual input tax") used for both taxable and exempt supplies must be apportioned according to use based on the following formula:[178]

Residual input tax recoverable = total residual input tax * total amount of taxable supplies made by the taxable person during the preceding financial year / total amount of supplies made by the taxable person during the preceding financial year

In Ireland, where a taxable person carries out both taxable and exempt transactions, the taxable person is entitled to deduct a proportion of tax which correctly reflects the extent to which the goods and services are used for the purposes of that person's taxable supplies or activities and has due regard to the range of that person's total supplies and activities. In practice, Ireland allows the use of any apportionment method to the extent the apportionment correctly reflects the use to which the goods and services are put and also reflects the range of the taxable person's activities.[179]

In order promote neutrality, fairness, and certainty of the tax, the GST law should contain an apportionment provision addressing the special case of taxable persons carrying on both taxable and exempt supplies.

Based on the comparative jurisdictions, it is recommended for simplicity, fairness, and flexibility purposes that the GST law contains a *de minimis* provision. Such a provision should relieve the taxable person from any apportionment obligation where the taxable person only performs a certain dollar value threshold of exempt supplies and under a certain percentage of exempt supplies of total supplies. For this purpose the dollar value threshold should be based on a calendar month and the percentage threshold on a taxable period basis.

Referring to the previous financial year, as does the IMF Model Law, would increase the complexity of the law and require an end of year adjustment to reflect the reality of the supplies performed during the current financial year.

The GST law should also provide that incidental financial transactions do not fall within the apportionment rules. For this purpose, the GST law may include a list of supplies that qualify as

[177] IMF Model Law, § 28(4).
[178] IMF Model Law, §. 28(3).
[179] Irish VAT Act, § 61.

"incidental." The GST law should further clarify that where a taxable person is in the business of carrying out exempt supplies, the incidental financial transactions rule does not apply.

Finally, the GST law should clearly state that, where a taxable person performs taxable and exempt supplies and the above *de minimis* rules are not applicable, input tax for the purpose of carrying out taxable supplies is deductible, but input tax incurred for carrying out exempt supplies is not deductible. Any residual input tax should be apportioned according to the following formula:

> Residual input tax deductible = residual input tax * taxable supplies during taxable period/total supplies during taxable period

Adjustment Rules

In New Zealand, after the initial claim of input tax deduction based on the intended use of the goods or services, a review of the actual use of the asset must be carried out every "adjustment period" (generally every 12 months).If the value of the goods and services (excluding GST) is more than NZD 5,000 and the *de minimis* rule described above did not apply to the acquisition, then at the end of an adjustment period the registered person must carry out an input tax adjustment if the "percentage actual use" of the asset differs from the "percentage intended use" by more than 10 percentage points and the adjustment amounts to more than NZD 1,000.[180]

The formula which must be applied in each "adjustment period" for calculating the required input tax adjustment is as follows: full input tax deduction * percentage difference.[181] If the adjustment is positive and the asset has actually been used for taxable purposes more than originally estimated, then adjustment is allowed as an additional input tax deduction.[182]If the adjustment is negative and the asset has actually been used for taxable purposes less than originally estimated, then the adjustment is a positive amount of output tax.[183]

The "first adjustment period" is defined as the period starting on the date of acquisition of the good or service and ending, at the person's election, on the person's first balance date following the date of acquisition or the person's first balance date that falls at least 12 months after the date of acquisition.[184]After the first adjustment period, each "subsequent adjustment period" is the 12-month period following the previous adjustment period.[185]For goods and services other than land, adjustments do not have to be made indefinitely. If the value of the goods and services (exclusive of GST) is:[186]

- between NZD 5,000 and NZD 10,000, there are only two adjustment periods;
- between NZD 10,000 and NZD 500,000, there are five adjustment periods; and
- greater than NZD 500,000, there are ten adjustment periods.

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[180] New Zealand GST Act, 21(2).
[181] New Zealand GST Act, § 21D.
[182] New Zealand GST Act, § 21D(3).
[183] New Zealand GST Act, § 21D(3).
[184] New Zealand GST Act, § 21G(2)(a).
[185] New Zealand GST Act, § 21G(2)(b).
[186] New Zealand GST Act, § 21G(4)(a).

For a supply of land, there is no limit to the number of adjustment periods.[187] A final adjustment must be calculated upon disposal or deemed disposal of an asset in the course of a taxable activity, where the original supply of the asset was subject to an input tax apportionment.[188]

Similar to New Zealand, in Singapore a taxable person, who has deducted input tax that has been attributed to taxable supplies because the intended use of the goods or services was for the making either taxable supplies or both taxable and exempt supplies, is required to adjust his input tax deduction when he subsequently uses or forms an intention to use the goods or services concerned to make (a greater proportion of) exempt supplies.[189] On the other hand, the tax authority must allow a deduction for input tax previously denied to a taxable person if the taxable person subsequently uses or forms an intention to use the goods or services concerned to make (a greater proportion of) taxable supplies.[190]

Singapore requires partially exempt persons to perform adjustments of their input tax deducted during a period of five years commencing on the first day of the accounting period in which the input tax was claimed.[191] Where the *de minimis* rule described above, in respect of apportionment, does not apply in a certain accounting period, but does over the relevant five year period, taxable persons can deduct the input tax not previously claimed. Conversely, if they pass the de *minimis rule* in any prescribed accounting period, but fail the rule at the end of the relevant five year period, they are required to adjust the input tax previously deducted.

The Malaysian adjustment regulations are not available in English.

The IMF Model Law does not contain a special provision regarding the change of use of goods and services purchased.

Ireland adopts a similar adjustment regime as New Zealand and Singapore. The differences between the Irish regime and those regimes are not material.[192]

The common theme among the comparable jurisdictions is that, after the initial apportionment, ongoing adjustments are required based on actual use. The extent and duration of the adjustments and when those adjustments should be made vary from jurisdiction to jurisdiction.

For a GST to be neutral and fair, the GST law should provide special rules where the use of goods and services changes following the initial apportionment of input tax credits. However, for efficiency and simplicity purposes, the rule should only apply to goods and services of a certain dollar value threshold where the use changes within a pre-determined time period.

However, taxable persons should not be required to make any adjustment of the input tax deducted where the change in use is not above a certain percentage. For simplicity purposes, it

[187] New Zealand GST Act, § 21G(5).
[188] New Zealand GST Act, § 21F.
[189] Singapore GST Regulations, regulation 37.
[190] Singapore GST Regulations, regulation 39.
[191] Singapore GST Regulations, regulation 36.
[192] Irish VAT Act, § 64.

is recommended that no adjustment is required where the goods or services subject to the adjustment provisions are lost or unintentionally destroyed.

The GST law should also address in this section, adjustments resulting due in the issuance of tax credit notes or tax debit notes. Please refer to section 3.D.9 regarding credit notes and debit notes.

3.D.7 Bad Debts

Overview of Concept

Given that GST is generally accounted for prior to payment being received under the accrual basis of accounting, situations frequently occur where GST is paid to the tax authority but payment for the underlying supply is never received by the taxable person from the recipient of the supply, giving rise to a bad debt. In such cases, requiring the taxable person to pay the GST on the supply conflicts with the intended business neutrality of the tax and the principle that GST should be levied on the consideration for supply.

As such, where a bad debt arises and GST has already been accounted for by the taxable person, the taxable person should be permitted to claim a credit for the GST to the extent of the non-payment for the supply.

Leading Practice

The bad debt provision should be drafted to include the following:

- Bad debt should be defined as any debt relating to a supply of goods or services that is not recovered within a certain timeframe from the time of supply or where the customer has become insolvent.
- The supplier should send a credit note to the customer to inform him that the debt qualifies as bad debt under the GST law.
- Suppliers should be allowed to deduct input tax equal to the GST portion of bad debts after sending the credit note.
- Any amount recovered after the bad debt relief is applied is considered as a taxable supply and the supplier must account for output tax on the amount recovered.

Discussion

In New Zealand, a supplier is entitled to a deduction from output tax in the case of a bad debt that the supplier has written off.[193]The deductible amount is the portion of GST charged on the supply, calculated from the ratio of the amount written off as a bad debt to the total consideration for the supply.[194]If the written-off debt is wholly or partly recovered by the registered person, that portion of the amount of the deduction which has been claimed, calculated from the ratio of the amount of the bad debt recovered to the bad debt written off is deemed to be the tax charged

[193] New Zealand GST Act, § 20(3)(i).
[194] New Zealand GST Act, § 26.

in relation to a taxable supply made during the taxable period in which the bad debt is wholly or partly recovered.[195]

Singapore allows suppliers who have attempted to collect a GST debt, but are unable to recover the money after 12 months, to apply for bad debt relief and receive a refund of the GST previously accounted for and paid provided they took reasonable steps to recover the debts.

In addition, Singapore also has rules that apply to the recipient of the supply. A taxable person who fails to pay his supplier the consideration for the supply of any goods or services, and who has credited the input tax to which the consideration which he failed to pay relates, is required to repay such amount to the Comptroller in the prescribed accounting period.[196] Should he subsequently make payment to his supplier, the taxable person is allowed to credit the same amount of input tax in the prescribed accounting period in which he makes the payment.[197]

In Malaysia, the GST portion of the bad debt can be reclaimed provided that the claimant has not received any payment after 6 months of date of supply or the debtor has become insolvent before the period of 6 months has elapsed, and the tax authority is satisfied that all reasonable efforts have been made by the claimant to recover the debt.[198] The refund of the GST portion of the bad debt is done through an adjustment to the input tax in any taxable period. Any payment recovered by the taxable person after the adjustment is deemed to be a taxable supply.[199]

Under the IMF Model Law, a taxable person is allowed an input tax deduction for the VAT portion of a bad debt.[200] An input tax deduction is only granted for supplies made to non-taxable persons or where a credit note has been issued to a taxable person.[201] Any payment recovered by the taxable person after the adjustment is deemed to be a taxable supply.[202]

Ireland permits a deduction in respect of the VAT on a bad debt when all reasonable steps to recover the bad debt have been undertaken but no consideration has been received. [203] Where a credit for a bad debt is claimed, a credit note must be issued by the supplier.

All comparable jurisdictions provide a relief for bad debts. Differences arise in respect of what qualifies as a bad debt and the requirement to issue a credit note. All jurisdictions require the repayment of any input tax claimed in respect of a bad debt to the extent that the debt is subsequently recovered.

We suggest that the supplier should be allowed to claim an input tax deduction equal to the GST portion of the bad debt. Should the supplier recover any amount treated as bad debt after deducting the input tax, the GST amount relating to the recovered amount should be considered

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[195] New Zealand GST Act, § 26(2).
[196] Singapore GST Act, § 19(12).
[197] Singapore GST Act, § 19(12A).
[198] Malaysia GST Act, § 58(1).
[199] Malaysia GST Act, § 58(3).
[200] IMF Law, § 30.
[201] IMF Law, § 30(5).
[202] IMF Law, § 30(4).
[203] Irish VAT Regulation 10.

as output tax. The approach of Ireland and the IMF of issuing a credit note for a bad debt creates a good paper trail and should be considered leading practice. Further, this will require the customer to apply the general rules relating to credit notes and thus correct the input tax originally deducted with no payment having been made (see 3.D.6 and 3.D.9).

3.D.8 Refund of Excess Input Tax

Overview of Concept

As discussed above in section 3.D.4 in respect of the calculation of tax payable, where during a taxable period the amount of deductible input tax exceeds the attributable output tax, the excess input tax amount should be refunded to the taxable person in accordance with the refund of excess tax rules.

Given that GST is intended to be a business neutral tax, taxable persons should be entitled to a refund of the excess input tax. Thus, provisions that address the refunding of any excess GST are required.

Providing rules in respect of the refund of GST also promotes certainty for taxable persons.

Leading Practice

The refund provision should be drafted to include the following:

- Where during a taxable period the amount of input tax exceeds the amount of output tax, the excess of input tax should be refunded to the taxable person.
- Payment of the refundable amount should be made by the tax authority within a certain number of working days after the return was received by the tax authority.
- The Secretary should have the power to withhold any refundable amount to offset against unpaid taxes, any amount under investigation, or where there are outstanding returns.

Discussion

The New Zealand GST Act allows the tax authority to apply any excess of input tax to other tax debts owed by the registered person.[204]If the registered person has no other tax debts and the Commissioner is satisfied that the amount of the GST refund is correct, then the tax authority must pay the refund within 15 working days of receiving the registered person's return where the registered person is a New Zealand resident.

The Commissioner can withhold any refund where the amount refundable is under investigation or where there are outstanding returns.

In Singapore, the tax authority must refund any excess input tax within a period equivalent to the prescribed taxable period after the return to which the payment relates is received by the tax authority.[205]Consequently, a registered person whose prescribed taxable period is on a quarterly

[204] New Zealand GST Act, § 46.

[205] Singapore GST Act, § 19(5); Singapore GST Regulations, regulation 63.

basis will get a refund within 3 months from the date the return was submitted. In addition, the tax authority is entitled to hold over the whole or any part of an input tax credit to a subsequent period.[206]

As with New Zealand, a GST refund may be withheld and applied against other unpaid taxes.

In Malaysia, if the amount of input tax exceeds the amount of output tax in a taxable period, the balance will be refunded.[207] The refund will be made within 14 working days after the return to which the refund relates is received in the case of online submission and 28 working days after the return to which the refund relates is received in the case of manual submission.[208] However, any refundable amount may be held over to be credited to any following or subsequent taxable period either on the taxable person's request or on any direction given by the tax authority.[209] The tax authority may also withhold any refund payment to offset unpaid taxes.[210]

Under the IMF Model Law, excess input tax must first be carried forward and the taxable person must be in a refund position for three consecutive taxable periods before the taxable person can claim the refund.[211] The refund must be made within 2 months of the claim being made.

Ireland is similar to the above regimes but requires the filing of a separate refund claim for the refund to be issued.[212]

Granting a refund of excess tax is considered business friendly and promotes the neutrality and fairness of the tax. The GST law should thus authorize refunds for taxable persons who are in a refund position during a given taxable period.

The refund should be paid out within a short timeframe after receipt of the return. This will reduce any cash flow impact on businesses that are in regular refund position. The taxable person should not be required to file a separate claim for the issuance of the refund in order to promote simplicity and efficiency. However, the tax authority should have the power to retain a refund where an investigation or audit is commenced or where the taxable person has outstanding returns. Further, where a taxable person has other tax debts, the refund should first be applied in satisfaction of those debts prior to issuance.

3.D.9 Tax Invoices, Credit Notes, and Debit Notes

Overview of Concept

A tax invoice is a document issued by a taxable person who makes a taxable supply that records the details of the supply and the amount of GST charged.

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[206] Singapore GST Act, § 19(6).
[207] Malaysia GST Act, § 38(3).
[208] Malaysia, GST Guide for Input Tax Credit, at 37.
[209] Malaysia GST Act, § 38(4).
[210] Malaysia GST Act, § 45.
[211] IMF Model VAT Law of New Vatopia, art. 45.
[212] Irish VAT law, regulation 36.

Credit notes and debit notes are documents that evidence the adjustment of the value of a previously made supply following the issuance of a tax invoice.

In an invoice-based GST system, these documents create a valuable audit trail for enforcement purposes. Further, without holding a valid tax invoice, purchasers are generally unable to claim credits for any input tax incurred on their expenses. This provides a valuable control within the supply chain, creating an element of self enforcement.

Consequently, GST laws generally outline the situations where these document must be issued and what form they should take.

Leading Practice

The tax invoice provision should be drafted to include the following:

- Registered persons should be required to issue a tax invoice for taxable supplies within a specified number of days after the delivery or making available of the goods or the completion of the performance of the services.
- A "tax invoice" should contain at least the following information:
  - The words "tax invoice" listed on prominent place;
  - Name, address, and GST number of the registered person making the supply;
  - Name, address and GST number (if registered) of the recipient to whom the supply is made (if the value of the supply is greater than US$1,000);
  - Invoice date;
  - Sequential number of the invoice;
  - The nature of the supply made (type of supply, type of goods or services, and quantity of goods or extent of service);
  - The amount of payment for the supply (excluding GST); and
  - The amount of GST.
  - The total amount, including GST.
- A registered person is required to issue a tax credit note or tax debit note when:
  - there is a change in the consideration due on a supply; or
  - when the supply is cancelled.
- Registered persons should be required to issue a tax credit note or tax debit note within a specified number of days after the change in the consideration due on a supply occurs, in case of bad debts, or when the supply is cancelled.
- A "tax credit note" or "tax debit note" should contain at least the following information:
  - the words "credit note" or "debit note" in a prominent place;
  - the name, address, and GST registration number of the registered person making the supply;
  - the name, address and GST Registration of the recipient of the supply (if registered);
  - the date on which the credit or debit note is issued;
  - Sequential number of the credit or debit note;
  - the value of the supply shown on the tax invoice, the correct amount of the value of the supply, the difference between those two amounts, and the tax charged that relates to that difference;

- a brief explanation of the circumstances giving rise to the issuing of the credit or debit note; and
- the number and date of the original tax invoice.

- A tax invoice, tax credit note, or tax debit note may be issued in electronic form provided the registered person can ascertain the authenticity of origin, the integrity of content, and the legibility of the document.

Discussion

Tax Invoice

In New Zealand, a registered person who makes a taxable supply of more than NZD 50 must provide the purchaser with a tax invoice if the purchaser requests one.[213]The tax invoice must then be issued within 28 days of the request.[214] Under New Zealand law there is a difference between an "invoice,"[215]which triggers time of supply and is simply any document which notifies an obligation to make payment and a "tax invoice,"[216]which is an invoice that meets certain requirements and allows a registered person to claim an input tax credit.

Tax invoices must contain the information set out below.

In New Zealand, a valid tax invoice must contain the following information:[217]

- the words "tax invoice" in a prominent place;
- the name and registration number of the supplier;
- the date it was issued;
- a description of the goods and services supplied;
- the consideration for the supply;
- the name and address of the recipient;
- the quantity or volume of the goods and services supplied; and
- either the total amount of the GST charged, the price before GST and the price with GST, or if the GST charged is a fraction of the price, the price and a statement that it includes GST.

Tax invoices may be issued in paper or electronic form. There is no prescribed format. In addition to tax invoices, there are special types of tax invoices in the following situations:

- the consideration for the supply does not exceed NZD 1,000 (and is not a zero-rated supply) –this is referred to as a "simplified tax invoice;"

[213] New Zealand GST Act, § 24.
[214] New Zealand GST Act, § 24(1).
[215] New Zealand GST Act, § 2.
[216] New Zealand GST Act, § 24.
[217] New Zealand GST Act, § 24(3).

- the supply is of second-hand goods – this is referred to as a "second-hand goods tax invoice," a buyer-created tax invoice; and
- shared tax invoices for groups.

Singapore requires a registered taxable person making a taxable supply to a taxable person to provide the latter with a tax invoice.[218] The tax invoice must be issued within 30 days of the time of supply. As with New Zealand, no tax invoice needs to be issued for zero-rated supplies, exempt supplies, or deemed supplies. There is also no need to issue tax invoices to non-GST registered persons.

However, unlike New Zealand, the Singapore GST Act requires a receipt to be issued for every taxable supply made, unless a tax invoice has already been issued.[219]Consequently, at least a receipt must be issued to a non-GST registered person. Tax invoices may be issued in paper or electronic form. There is no prescribed format.

In Singapore, a valid tax invoice must contain the following information:[220]

- the words "tax invoice" in a prominent place;
- an identifying number;
- the date of issue of the invoice;
- the name, address and registration number of the supplier;
- the name and address of the person to whom the goods or services are supplied;
- a description sufficient to identify the goods or services supplied and the type of supply;
- for each description, the quantity of the goods or the extent of the services and the amount payable, excluding tax;
- any cash discount offered;
- the total amount payable excluding tax, the rate of tax and the total tax chargeable shown as a separate amount; and
- the total amount payable including the total tax chargeable.

In addition, Singapore has the following types of special types of invoices:

- "self-billing" arrangement in which the customer may issue a tax invoice on behalf of his supplier and forward a copy of the tax invoice to the supplier;221 and
- "simplified invoices" when the amount payable on the tax invoice, including the tax, does not exceed SGD 1,000.[222]

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[218] Singapore GST Act, § 41(1); Singapore GST Regulations, regulation 10.
[219] Singapore GST Act, § 44;
[220] Singapore GST Regulations, regulation 11.
[221] Singapore GST Regulations, regulation 10(4).
[222] Singapore GST Regulations, regulation 13.

In Malaysia, every registered person who makes taxable supply of goods and services is required to issue a tax invoice.[223]Tax invoices must be issued within 21 days from the time of supply.[224]However, no tax invoice needs to be issued for zero-rated supplies, deemed supplies, or supplies under a special scheme under the GST Act. Tax invoices may be issued in paper or electronic form. There is no prescribed format.

In Malaysia, a valid tax invoice must contain the following information:[225]

- the words "tax invoice" in a prominent place;
- the tax invoice serial number;
- the date of issuance of the tax invoice;
- the name, address, and identification number of the supplier;
- the name and address to whom goods or services are supplied;
- a description sufficient to identify the goods or services supplied;
- for each description, distinguish the type of supply for zero rate; standard rate and exempt, the quantity of the goods or the extent of the services supplied and the amount payable, excluding tax;
- any discount offered;
- the total amount payable excluding tax, the rate of tax and the total tax chargeable to be shown separately;
- the total amount payable inclusive of the total tax chargeable; and
- any amount disclosed must be expressed in Malaysian Ringgit.

In addition, Malaysia has the following types of special types of invoices:

- self-billed invoice;
- simplified invoices; and
- invoice or statement of sales by auctioneer.

Under the IMF Model Law, a taxable person is required to issue a tax invoice for taxable supplies to another taxable person.[226] If 60 days after the date of supply the recipient does not receive a tax invoice, the recipient may request the supplier to issue such an invoice.[227] No tax invoice must be issued if the total consideration for the taxable supply is in cash and does not exceed a certain amount.[228] The IMF Model VAT Law does not address the format under which invoices should be issued.

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[223] Malaysia GST Act, § 33.
[224] Malaysia GST Guide, Tax Invoice and Record Keeping (DRAFT), at 3.
[225]Malaysia GST Act, Schedule IV.
[226] IMF Model Law, § 32.
[227] IMF Model Law, § 32(5).
[228] IMF Model Law, § 32(2).

Under the IMF Model Law, a valid tax invoice must contain the following information:[229]

- the words "tax invoice" in a prominent place;
- the name, address, and VAT registration number of the registered person making the supply;
- for a supply to a registered recipient, the name, address, and VAT registration number of the recipient of the supply;
- the individualized serial number and the date on which the tax invoice is issued;
- a description of the goods or services supplied;
- the quantity or volume of the goods or services supplied; and
- the total amount of the tax charged, the consideration for the supply, and the consideration including tax.

In Ireland, a taxable person who makes a taxable supply to another taxable person, a public body, or a person carrying on an exempted activity is required to issue a tax invoice. A simplified invoice may be issued if the amount of the invoice is not greater than €100, or when commercial, technical or administrative practices in a particular business sector make it difficult to comply with general invoicing requirements. The invoice must be issued within 15 days of the time of supply.[230]

The VAT invoice issued must show:

- the date of issue of the invoice;
- a sequential number, based on one or more series, which uniquely identifies the invoice;
- the full name, address and the registration number of the person who supplied the goods or services to which the invoice relates;
- the full name and address of the person to whom the goods or services were supplied;
- in the case of a reverse charge an indication that a reverse charge applies;
- the quantity and nature of the goods supplied or the extent and nature of the services rendered;
- the date on which the goods or services were supplied or, in the case of early payment prior to the completion of the supply, the date on which the payment on account was made, in so far as that date differs from the date of issue of the invoice;
- in respect of the goods or services supplied:
    - the unite price exclusive of VAT;
    - any discounts or price reductions not included in the unit price; and

[229] Singapore GST Regulations, regulation 11.
[230] Irish VAT Act, §§ 66-73.

- the consideration exclusive of VAT.

- in respect of the goods or services supplied, other than reverse charge supplies:
  - the consideration exclusive of tax for each rate (including zero-rate) of VAT; and
  - the rate of VAT chargeable.
- the VAT payable in respect of the supply.

Tax invoices may be issued in paper or electronic form (Ireland provides specific rules for issuing invoices in electronic format).

In addition, Ireland has special types of invoices including for:

- self-billed invoice;
- simplified invoices; and
- margin scheme.

All comparable jurisdictions require the issuance of an invoice. In most cases, formal tax invoices are only required where supplies are made to registered persons. However, due to the risk of fraud and evasion in Puerto Rico, tax invoices should be issued for all taxable supplies, irrespective of the nature of the recipient of the supply. As with all the comparable jurisdictions, prescriptive requirements for the content of a tax invoice should be included within the legislation. The only simplification should be for supplies of a value not greater than $1,000, in which case the invoice should not be required to contain the name, address and GST number (if registered) of the recipient to whom the supply is made. This exception should address most retail sales and thus reduce the compliance burden.

The GST leading practice approach departs from the current SUT system, under which a merchant is responsible to issue any receipt, invoice, ticket, or other evidence of sale.[231] However, the current SUT does not provide for invoicing requirements as the invoice does not constitute the principal mechanism to combat tax fraud and avoidance. Rather, the SUT puts an emphasis on the importance of exemption certificates such as the reseller certificates. Due to the input tax deduction mechanism (see 3.D.5), the requirement to issue valid tax invoices should create a more reliable paper trail of all transactions subject to GST and ensure to a certain extent that the tax is self-enforced by all taxable persons.

Tax Credit Note and Tax Debit Note

In New Zealand, where a tax invoice shows an incorrect GST amount, the supplier must issue a credit or debit note to the recipient.[232] A credit or debit note must be issued when:

- a supply of goods and services has been cancelled;
- the nature of that supply of goods and services has been fundamentally varied or altered;

[231] PRIRC § 4020.05(b).
[232] New Zealand GST Act, § 25.

- the previously agreed consideration for that supply of goods and services has been altered(whether due to the offer of a discount or otherwise); or
- the goods and services or part of those goods and services supplied have been returned to the supplier.

And

- the supplier has provided a tax invoice in relation to that supply and as a result of any one or more of the above events:
  - the amount shown on the tax invoice as GST charged on that supply is incorrect; or
  - the supplier has submitted a return in relation to the taxable period for which output tax on that supply is attributable and, as a result of any one or more of the above events, has accounted for an incorrect amount of output tax on that supply.

For a registered recipient, that adjustment must be made if the price has decreased and the recipient has been issued with a credit note, but is optional if the price has increased and the recipient has been issued with a debit note.[233]The tax authority retains discretion to determine that a credit or debit note need not be issued, or need not contain any of the requirements in circumstances where it is impracticable.

A valid tax credit note or tax debit note must contain the following information:[234]

- the words "credit note" or "debit note" in a prominent place;
- the name and registration number of the supplier;
- the date it was issued;
- the name and address of the recipient;
- the amount of consideration for that supply contained in the tax invoice, the correct amount of consideration, the difference between those two amounts, and the tax charged in respect of that supply; and
- a brief explanation of the circumstances giving rise to the issuing of the credit or debit note.

The Singapore GST Act does not define the situations when a credit note is to be used except where there is a change in the rate of GST and the supplier has to issue the tax invoice to reflect the new rate.[235] In practice, the Singapore tax authority recognizes that a credit note should be issued when:[236]

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[233]K. Holmes, *New Zealand - Corporate Taxation* sec. 13., Country Analyses IBFD.
[234] New Zealand GST Act, § 25(3).
[235] Singapore GST Regulations, regulation 12.
[236]D. Kaur, *Singapore - Corporate Taxation* sec. 13., Country Analyses IBFD.

- correcting a genuine mistake (e.g., goods invoiced as standard-rated which should have been exempt or zero rated);
- the supply did not take place;
- charges are partly or fully waived before/after delivery of the goods;
- goods or services are accepted, but terms of the contract are not fully met (e.g., sub-standard goods are accepted by the customer at a reduced price);
- goods are returned or services are not accepted; or
- goods and services are supplied for an unconfirmed consideration.

The GST Act does not address tax debit notes.

In Singapore, credit notes should contain the number and date of the original tax invoice to which the credit note relates, in addition to the following particulars:

- an identifying number (e.g., a serial number);
- the date of issue;
- the name, address and GST registration number of the supplier;
- the customer's name and address;
- the reason for the credit – for example, "returned goods;"
- a description sufficient to identify the goods and services for which credit is being allowed;
- the quantity and amount credited for each description;
- the total amount credited, excluding tax;
- the rate and amount of tax credited; and
- the total amount credited, including tax.

In Malaysia, the GST Act provides the requirement for the issuance of credit and debit notes in respect of a supply.[237] The consideration for a particular supply can only be altered by means of a credit or debit note.[238]Where there is any such change in the consideration, the person making or receiving the supply, as the case may be, shall within twenty-one days (21 days)after any such change or events, or within such longer period as the Director General may allow, issue a credit note or debit note.[239] The issuance of credit and debit notes by the registered person occurs when there is a change in the consideration due on a supply including a change in the rate of tax or a change in the descriptions of the zero-rated or exempt supply or a cancellation of the supply.

In Malaysia, a valid tax credit or debit note must contain the following information:[240]

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[237] Malaysia GST Act, § 35.
[238] Malaysia GST Act, § 35.
[239] Malaysia GST Guide, Tax Invoice and Record Keeping (DRAFT), at 24.
[240] Malaysia GST Guide, Tax Invoice and Record Keeping (DRAFT), at 26.

- the words "credit note" or "debit note" in a prominent place;
- the serial number;
- the date of issuance;
- the name, address, and identification number of the supplier;
- the name and address to whom goods or services are supplied;
- the reasons for its issue;
- description of the goods and services;
- the quantity and amount for each supply;
- the total amount payable excluding tax,
- the rate of tax and the total tax chargeable; and
- the number and date of the original tax invoice.

Under the IMF Model Law, a valid credit or debit note must be issued when the amount shown as tax charged in the tax invoice exceeds the tax properly chargeable in respect of the supply.[241] Only where a supplier issues a tax credit note to rectify the output tax charged to a recipient, the additional tax specified in the tax credit note is treated as output tax payable by the recipient in respect of a taxable supply made by the recipient in the tax period in which the tax credit note is received.[242]In addition, a taxable person is required to issue a debit note where the tax properly chargeable in respect of the supply exceeds the amount shown as tax charged in a tax invoice.[243] Where a registered person issues a tax debit note to rectify the output tax charged to a registered recipient, the additional tax specified in the tax debit note is deemed to be input tax payable by the registered recipient in the tax period in which the tax debit note is received.[244]

Under the IMF Model Law, a valid tax invoice must contain the following information:[245]

- the words "tax credit note" or "tax debit note" in a prominent place;
- the name, address, and VAT registration number of the registered person making the supply;
- the name, address, and VAT registration number of the recipient of the supply;
- the date on which the credit or debit note is issued;
- the value of the supply shown on the tax invoice, the correct amount of the value of the supply, the difference between those two amounts, and the tax charged that relates to that difference;

[241] IMF Model Law, § 33(1).
[242] IMF Model Law, § 29(7).
[243] IMF Model Law, § 33(3).
[244] IMF Model Law, § 29(5).
[245] IMF Model Law, Schedule IV.

- a brief explanation of the circumstances giving rise to the issuing of the credit or debit note; and
- information sufficient to identify the taxable supply to which credit or debit note relates.

The Irish VAT Act requires taxable persons to issue credit and debit notes when, after issuance of an invoice, the consideration stated in the invoice is increased or reduced, or a discount is allowed.[246] Where there is any such change in the consideration, the person making or receiving the supply, as the case may be, shall within fifteen (15 days) after any such change or events issue a credit note or debit note. In Ireland a debit note is considered as an additional invoice and thus follows the same invoicing requirements. The credit note must show:

- the date of issue of the note;
- a number, which uniquely identifies the note;
- the full name, address and VAT registration number of the person issuing the note;
- the full name, address and VAT registration number of the person to whom the note is being issued;
- in the case of a supply to a person who is registered for value-added tax in another EU Member State, the person's VAT identification number in that Member State;
- the reason why the note is being issued and a cross-reference to the invoice which was issued for the supply in respect of which the consideration was reduced;
- the amount of the consideration, exclusive of tax, in respect of which the note is being issued; and
- the rate or rates of tax in force when the related invoice was issued and the amount of tax at each rate as appropriate to the consideration shown on the note (other than where the reverse charge applied on the transaction).

In order to avoid fraud, GST adjustments relating to post sale adjustments should only be permitted where a valid tax credit note or tax debit note is issued. The GST law should thus indicate clearly in which situations registered persons are required to issue tax credit notes and tax debit notes. For simplicity purposes, tax credit and debit notes should be issued when there is a change in the consideration due on a supply or when the supply is cancelled. For efficiency and certainty purposes, the GST law should require registered person to issue a tax credit note or tax debit note within a certain timeframe after the changed occurred.

[246] Irish VAT Act, §§ 66-73.

Appendix D: Goods and Services Tax Special Cases

Appendix D: Goods and Services Tax Special Cases

1.A Special Cases

1.A.1 Grouping

Overview of concept

Under a GST, each person carrying on a taxable activity is required to register for GST and comply with the GST law. However, some countries allow closely related entities to form a GST group whereby all members of a GST Group will be considered as a single taxable person for GST purposes. This mechanism is generally designed to reduce the compliance burden by requiring the group as a whole to file a single return rather than having each entity file a separate return.

Where a GST group is formed, one entity designated as the group's representative files returns on behalf of the group that includes all transactions made and received by group members. In addition, because all members of a GST group are considered to constitute a single taxable person, transactions between GST group members are ignored for GST purposes. This has a consequential beneficial effect of removing any cash flow burden that may arise from accounting for GST on such supplies.[247]

Caution is required to be exercised when drafting rules in respect of GST grouping to ensure the operation of the GST is not adversely affected. Specifically, input tax credits incurred by a group member related to the making of exempt supplies to another group member should not be recoverable based on the taxable supplies made by the group as a whole. This issue is addressed in different ways by jurisdictions having implemented a GST grouping provision and are discussed below.

Leading Practice

The GST law should include a GST grouping provision, which should include the following:

- Two or more taxable persons established in Puerto Rico may apply to the authority to form a GST group provided that:
    - there is an element of common control between members (based on existing commercial and income tax concepts);
    - each member must make 100% taxable supplies (incidental exempt supplies should be ignored for the calculation of this percentage).
- If all the conditions for a GST group are met:
    - one member of the group should be designated as the GST group representative;
    - all transactions between group members should be deemed outside the scope of GST.
- All members of a GST group are jointly and severally liable for the payment of the tax.
- Where a member of the GST group no longer meets the common control requirement, it should be excluded from the GST group effective from the end of the taxable period in which the requirement ceased to be met.

[247] *Improving VAT/GST – Designing a Simple and Fraud-Proof Tax System*, at 17.1.4, IBFD (2014).

Discussion

In New Zealand, GST grouping is permitted provided that (1) all companies are registered persons for GST purposes; (2) there is a 66% common ownership among the members of the GST group; (3) all companies make collectively taxable supplies to non-group members that amount to at least 7 5% of their total supplies made to non-group members; (4) group members account for GST on the same basis (payments or invoice), and (5) group members have the same taxable periods.[248] Individuals, partnerships, trusts, and non-resident entities may join a GST group where certain control tests are satisfied. Where a GST group is formed, one company must be nominated as the "representative member" of the group. It is the representative member which is deemed to carry on all the taxable activities of the group members, and make and receive all supplies made by and to group members. Each individual member is deemed not to carry on that taxable activity or individually make or receive supplies for GST purposes. The representative member is responsible for filing GST returns and paying GST to the tax authority. However, each group member remains jointly and severally liable for the GST liability of the group.

In Singapore, GST Grouping is also permitted provided there is an element of common control over the members of the GST group.[249]Group registration is available to two or more taxable persons, each of whom must possess at least one of the following attributes:

- the taxable person is resident in Singapore or has a business establishment in Singapore;
- the taxable person has an annual turnover of SGD 1 million or more;
- the taxable person has issued shares which are listed on a securities exchange established in or outside Singapore;
- the taxable person is a subsidiary of a body corporate that satisfies the conditions above; or
- the taxable person is financed by an entity that satisfies the conditions above.

In addition, the taxable person must meet at least one of the following control requirements: (1) one taxable person controls each of the other taxable persons, (2) one person (whether a body corporate or an individual) controls all of the taxable persons; or (3) two or more individuals carrying on a business in partnership control all of the taxable persons.[250]

Furthermore, similar to New Zealand, the tax authority also requires each member of the proposed group to be individually registered for GST and can refuse an application for the protection of revenue.

In contrast to New Zealand, the above requirements are more restrictive and there is no threshold requirement in respect of taxable versus exempt supplies. Nonetheless, the effects of GST grouping are the same as New Zealand.

[248] New Zealand GST Act, § 55.
[249] Singapore GST Act, § 30; Singapore GST Regulations, regulation 4.
[250] Singapore GST Act, § 30; Singapore GST Regulations, regulation 4.

The Malaysian GST Act allows group registration for two or more companies provided the following conditions are met:[251]

- Each company must be making wholly taxable supplies. However, where a company is making incidental exempt supplies, the company is also allowed to be a member of the group (cf. New Zealand with a 75% taxable supplies threshold and Singapore with no threshold);
- Each company must be individually GST registered before they can register as a group (similar to New Zealand and Singapore);
- One company must have controlling power over the other companies within the group (similar to New Zealand and Singapore).

Generally, a company is deemed to have control over another company if the first company holds directly, or indirectly, through subsidiaries, more than 50% of the issued share capital of the second mentioned company. A company is deemed to be a subsidiary of another company if that company holds more than 50% of the share capital of the first mentioned company.

In contrast to New Zealand and Singapore, individuals or partnerships are not eligible to be a member of a group. However, companies controlled by individuals or partnerships may register as a group. Again, in contrast to New Zealand and Singapore, foreign companies which are not established in Malaysia cannot become members of a group. However, for the purpose of eligibility for group registration, their subsidiaries or registered branches in Malaysia can be considered as members of a group.[252]

The consequences of GST grouping in Malaysia are the same as in New Zealand and Singapore.

The IMF Model Law does not include any specific provisions for groups.

Ireland also permits the formation of a VAT group by two or more persons closely bound by financial, economic and organizational links.[253] Companies are treated as being "closely linked" if one owns 50 percent or more of the share capital of the other, or one owns 50 percent or more of the voting power of another, or one has power to appoint 50 percent or more of the board of the other.[254] Similar to Malaysia, only Irish established entities may be members of a group. Unlike in the other comparable jurisdictions, the Irish tax authority may deem a person to be a member of a VAT group and also has authority to cancel the registration of such groups.[255]

The effects of VAT grouping in Ireland are the same as in the other comparable jurisdictions. However, the VAT group provisions do not apply in the case of the supply of immovable goods by a group member to another group member.

Based on comparable jurisdictions, it is leading practice to include GST grouping provisions within the GST law to help ease the compliance burden for closely related entities. Common characteristics of GST grouping provisions include:

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[251] Malaysia GST Act, § 27; Malaysia GST Guide, GST Registration Guide (DRAFT), at 17.
[252] Malaysia GST Guide, GST Registration Guide (DRAFT), at 17.
[253] Irish VAT Act, § 15.
[254] O. Maher, Ireland - Value Added Tax, Topical Analyses IBFD.
[255] Irish VAT Act, § 15.

- There is an element of common control between members;
- A representative member is appointed to file GST returns on behalf of the group;
- All members of the GST group remain jointly and severally liable for the payment of GST;
- Intra-group supplies are disregarded for GST purposes; and
- All supplies made to and by group members are deemed to be made to and by the group as a whole.

Differences arise in respect of how jurisdictions approach the following:

- Definition of common control;
- Whether group members are required to be established in a jurisdiction; and
- Whether group members are allowed to make exempt supplies.

In the case of Puerto Rico, the definition of common control should follow existing commercial and income tax concepts to ensure consistency.

In respect of allowing non-resident entities to be group members, there are contrasting approaches between the comparable jurisdictions. While New Zealand and Singapore authorize, to a certain extent, non-residents as members of GST groups, such an option is not available in Malaysia and Ireland. In the context of creating a simple and easily administrable GST, only authorizing established entities to be members of a GST group would be the preferable approach.

In order to address the potential over-deductibility of input tax that might arise from the forming of a GST group where exempt supplies are disregarded by virtue of the grouping provisions, the comparable jurisdictions have taken different approaches.

New Zealand imposes certain thresholds for carrying on taxable supplies therefore restricting entities that make significant exempt supplies from joining GST groups. Malaysia takes a more strict approach with only permitting GST grouping for members who make 100% taxable supplies. Ireland and Singapore have no restrictions. As such in Ireland, VAT grouping is commonly used to mitigate VAT costs arising from a group member making exempt supplies (e.g., in the finance or insurance industry).

Puerto Rico should follow the Malaysian approach with GST grouping only being permitted for taxable persons who make 100% taxable supplies (rather than the New Zealand approach which would require complex threshold computations), regardless of their status (i.e., corporations, individuals, partnerships, branches) which are established in Puerto Rico in order to avoid any GST tax planning opportunities.

The GST law should also state that where a taxable person no longer meets the common control requirement, the taxable person should be excluded from the GST group. However, the taxable person should remain jointly and severally liable for any GST payable during the taxable periods in which it was a member.

1.A.2 Branches and divisions

Overview of concept

Branches and divisions are not separate legal persons from their head offices. As such, GST regimes generally treat branches and divisions and their head offices as single taxable persons. Consequently, any transactions between head offices and branches are disregarded for GST purposes.

However, some countries allow or require branches and divisions to be regarded as separate taxable persons for two reasons:

- Allowing separate GST registrations for a head office and a branch can address compliance concerns where the head office and the branch operate separate accounting systems and in practice, despite the fact that they constitute one legal entity, are managed and operated as two distinct establishments. In such cases, requiring the filing of a single GST return may be overly burdensome for the taxable person.

- Where there are cross border supplies between a head office and a branch and GST is not fully recoverable by the recipient (i.e., where the recipient branch makes exempt supplies) the neutrality of a GST can be compromised where that head office - branch transaction is disregarded for GST purposes. As such, some jurisdictions deem cross-border supplies between head offices and branches to be a supply for GST purposes.

Leading Practice

The GST law should include a provision regarding branches and divisions, which should include the following:

- Where a taxable person carries out its taxable activity in branches or divisions, the taxable person is deemed to be a single taxable person.
- However, a taxable person carrying out its activity in branches or divisions should be authorized to apply for any such branch or division to be registered as a separate taxable person if:
    - The branch or division has an independent system of accounting, and
    - The branch or division can be separately identified by reference to the nature of the activities carried on or the location of the branch or division.
- Where a taxable person carries out taxable activities both inside and outside Puerto Rico through branches or divisions:
    - Each head office, branch, or division established overseas should be treated as a separate person;
    - All head offices, branches, or divisions established in Puerto Rico should be treated as a single person.

Discussion

New Zealand allows taxable persons carrying out their activity in branches or divisions to apply for any such branches or divisions to be registered as separate taxable persons where those branches or divisions have an independent system of accounting and can be separately identified by reference to the nature of the activities carried on or by the location of the branch or division.[256]

[256] New Zealand GST Act, § 56.

In addition, the GST Act treats the offshore branch or head office of a company and its head office or branch in New Zealand as separate persons to ensure there is no avoidance of any GST liabilities arising from cross border transactions, as described in the Overview of Concept section above.[257]Consequently, transactions between a resident head office and a non-resident branch will be treated as subject to the GST regime.

Singapore does not have any special provisions with regard to the treatment of transactions between a branch and its head office for GST. Consequently, where a branch has transactions with an overseas head office, the branch and the head office are considered as the same legal entity and thus there is no supply for GST purposes.[258] However, similar to New Zealand, an application can be made to register each division separately where (1) it is likely to cause real difficulty for the taxable person to submit a single return in respect of all the divisions; (2) each division maintains an independent system of accounting; and (3) each division is separately identifiable by reference to the nature of the activities carries on by or the location of the division.[259]

Malaysia takes a similar approach to Singapore and New Zealand authorizing the separate registration of branches and divisions under similar conditions.[260] In addition, for a separate branch or division registration, Malaysia requires that the taxable person and all the branches or divisions make wholly taxable supplies; the taxable person is not a member of a GST group; and each branch or division has the same taxable period. Once registered, all branches and divisions must charge and account for GST even though an individual branch or division may not have a turnover that exceeds RM500,000 (i.e., the registration threshold).

Under the IMF Model Law, where a taxable person carries out its taxable activity in branches or divisions, the taxable person is deemed to be a single person.[261] Consequently, transactions between head offices and branches are not subject to VAT. The law also authorizes taxable persons to apply for a separate registration for branches and divisions where the branch or division maintains an independent system of accounting and can be separately identified by the nature of its activities or its location (similar to New Zealand).[262]

The Irish VAT Act does not contain any specific provision regarding branches and divisions. However, under EU VAT case law, and in contrast to New Zealand, supplies of services between branches and head offices must be disregarded, even in cross border situations, because the transaction is within the same legal entity.[263] However, this does not apply to cross border supplies of services where a branch is a member of a VAT group.[264]

All comparable jurisdictions, except Ireland, contain special provisions regarding the separate registration of branches and divisions under certain circumstances. However, New Zealand is the

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[257] New Zealand GST Act, § 56B.
[258] *See e.g.*, Improving VAT/GST – Designing a Simple and Fraud-Proof Tax System, at 12.2.2.
[259] Singapore GST Regulation, regulation 7.
[260] Malaysia GST Act, § 30(2).
[261] IMF Model Law, § 56(1).
[262] IMF Model Law, § 56(3).
[263] Court of Justice of the European Union, Case C-210/04 *FCE Bank plc.*
[264] Court of Justice of the European Union, Case C-7/13, *Skandia America Corporation.*

only jurisdiction which deems cross border transactions between a head office and a branch to be a supply for GST purposes.

The GST Law may, similar to the IMF, clarify that where a business operates its taxable activity in branches or divisions, such branches or divisions should be considered carrying out the activity as a single taxable person. Consequently, all transactions between a head office, division, or branch will be disregarded for GST purposes. Such an approach provides certainty.

Based on the comparable jurisdictions, it is leading practice to allow a separate registration for branches or divisions where the branch or division maintains an independent system of accounting and can be separately identified by the nature of its activities or its location. Additional conditions such as those imposed by the Malaysian GST Act may be included, but is likely to add complexity to a provision deemed to provide flexibility to the law.

Finally, the GST law, should similar to New Zealand, deem cross-border transactions between head offices and branches to be supplies between two separate taxable persons for GST purposes. This provision will aid in maintaining the neutrality of the tax and mitigate avoidance opportunities.

1.A.3 Groups of persons/unincorporated bodies/partnerships

Overview of concept

Groups of persons, unincorporated bodies, and partnerships are often considered "pass-through entities" for income tax purposes, whereby partners or members of these entities are directly liable for tax. Applying the same principles for GST purposes may result in administrative and compliance complexities because each partner would be required to register for GST and special rules would be required for the artificial splitting of the supply between partners and the issuance of invoices. Consequently, GST laws generally introduce a mechanism that recognizes these entities as single taxable persons for GST purposes.[265] This will treat these entities as making or receiving all relevant supplies rather than supplies being made to or by each partner.

Leading Practice

The GST law should include a provision regarding groups of persons, unincorporated bodies, and partnerships, which should include the following:

- Where a group of persons, unincorporated body, or partnership carries on taxable activity, the group of persons, unincorporated body, or partnership is required to register for GST purposes in accordance with the registration rules.
- Members of the group of persons, unincorporated body, or partnership should not be registered for GST purposes except where they carry out a separate taxable activity to that carried out by the group of persons, unincorporated body, or partnership, of which they are a member.
- All supplies to and by members of the body are deemed to be made by or to the body and not the individual members.

[265] David Williams, *Tax Law Design and Drafting*, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996.

- All members of the group of persons, unincorporated body, or partnership are jointly and severally liable for any tax due.
- A person is required to notify the authority when he or she is no longer a member of the group of persons, unincorporated body, or partnership.
- The liability of a member will cease at the end of the taxable period in which he or she notified the authority that he or she is no longer a member of the group of person, unincorporated body, or partnership.

Discussion

Under the New Zealand GST Act, a "person" includes a company, an unincorporated body of persons, a public authority, or a local authority.[266] Consequently, any unincorporated body is subject to the general registration rules.[267] Where an unincorporated body of persons, including a partnership, joint venture or trustees of a trust, carrying on a taxable activity is registered for GST, the individual members of the unincorporated body are not themselves liable (or able) to register in respect of that taxable activity.[268] All supplies made or received in respect of the taxable activity carried on by the body are deemed to be made by or to the body and not the individual members. Changes in membership do not have any effect for the purposes of the GST Act. Each member of the unincorporated body is jointly and severally liable for the GST of the body for taxable periods in which they were members, even if they are no longer a member of the body.[269]

Singapore, Malaysia and the IMF adopt a similar approach to New Zealand.[270]

Ireland does not separately address the case of groups of persons, unincorporated bodies, and partnerships, which are thus subject to the general rules.

All comparable jurisdictions, except Ireland, adopt a specific provision regarding groups of persons, unincorporated bodies, and partnerships. New Zealand's approach, which is followed by Singapore, Malaysia, and the IMF, thus constitutes leading practice. Consequently, the GST law should provide for the following in respect of groups of persons, unincorporated bodies, and partnerships:

- Require that groups of persons, unincorporated bodies, and partnerships register for GST rather than the individual members;
- Consider all supplies to and by members of the body are deemed to be made by and to the body and not the individual members;
- Require a member to register separately where it performs a separate taxable activity;
- Hold jointly and severally liable all members for all taxes due; and
- Require a member to notify the tax authority where it is no longer a member of the body.

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[266] New Zealand GST Act, § 2.

[267] *See* Supra 3.C.

[268] New Zealand GST Act, § 57(2).

[269] New Zealand GST Act, § 57(3).

[270] Singapore GST Act, § 31 and 32, Malaysia GST Act, § 28, IMF Model Law, § 57.

1.A.4 Agents

Overview of concept

Where a supply of goods or services involves an agency relationship, generally the supply is made by or to the principal and not the agent. GST rules generally follow this principal. However, there may be situations where the agent does not reveal that there is an agency or declines to reveal the identity of the principal (e.g., undisclosed agent).[271] The general operation of the GST rules whereby the supplier is required to issue an invoice to the customer would potentially disrupt this commercial arrangement. As such, where an agent is acting in its own name but for and on behalf of a principal, many GST jurisdictions deem a buy/sell transaction to occur between the agent and the principal for GST purposes and GST purposes only.

Leading Practice

The GST law should include a provision regarding agents, which should include the following:

- When goods or services are supplied to or by a disclosed agent acting on behalf of a principal, the supply should be deemed to be made to or by the principal and not the agent.
- When goods or services are supplied through an undisclosed agent acting in its own name, the supply should be treated as a supply to the agent and as a supply by the agent.

Discussion

In New Zealand, where a person (the "agent") is authorized by another person (the "principal") to act, represent and/or enter into legally binding agreements with third parties on behalf of the principal, any supplies made by the agent pursuant to the agency relationship are deemed to be made by the principal and not the agent.[272]

However, a principal and their agent can agree in writing that a supply via the agent can be treated as two supplies – a supply of goods and services by the principal to the agent and a supply by the agent to the recipient.

Even in the event of no such agreement, an agent can issue a tax invoice for the supply as if it made the supply and can request a supplier to issue a tax invoice to the agent as if it received the supply. In such cases, tax invoices cannot also be issued by and to the principal, respectively.[273]

Similarly, where a registered person makes a taxable supply of goods or services to an agent, that supply is deemed to be made to the principal for GST purposes and not the agent.[274]

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[271] David Williams, Tax Law Design and Drafting, Chapter 6 Value Added Tax, Volume 1; International Monetary Fund, 1996 at p. 27.
[272] New Zealand GST Act, § 60(1).
[273] New Zealand GST Act, § 60(1) and (2).
[274] New Zealand GST Act, § 60(2).

Singapore has a similar approach to New Zealand. A supply of goods or services through an agent who acts in his own name can be treated both as a supply to the agent and as a supply by the agent.[275]

Malaysia is also similar to New Zealand in that when goods or services are supplied to or by the agent acting on behalf of a principal, the supply will be deemed as made to or by the principal and not the agent.[276]

However, where goods or services are supplied through an agent acting in his own name, the supply is treated as a supply to the agent and as a supply by the agent.[277]

The IMF adopts a similar approach to New Zealand in relation to invoicing but does not have a provision for deeming a supply to occur to and by the agent.[278]

Ireland takes a similar approach to agents as Malaysia where the agent is acting in its own name. Where an agent acts in an undisclosed capacity (i.e., in its own name, but on behalf of a principal), any sales of goods and/or services through him are deemed to constitute a supply of those goods and services to and simultaneously by the agent.[279]

Where an agent is a disclosed agent (i.e., in the name and on behalf of the principal), any supply of goods or service takes place directly between the principal and the third party.

All comparable jurisdictions include specific provisions regarding transactions performed through agents. Differences arise in respect of whether the legislation includes a provision confirming whether a supply through a disclosed agent is made to or by the principal (New Zealand and Malaysia), a provision deeming a buy/sell to occur where the supply is made through an undisclosed agent (Ireland and Malaysia), a provision providing the option for a deemed buy/sell (New Zealand and Singapore), and a provision allowing agents to issue invoices in their own name even in the absence of a buy/sell (New Zealand and the IMF).

For clarity purposes the GST law should state that where a supply is made through a disclosed agent the supply is made to or by the principal and not the agent. The GST law should also state that where supplies are made through an undisclosed agent there should be two distinct supplies: one by the agent and the other one to the agent. Such an approach is preferable as it avoids any difficulties for the third party to identify the principal where the principal's name is not disclosed for the purposes of issuing GST compliant invoices.

1.A.5 Going concerns

Overview of concept

Normally, the sale of the assets of a GST registered business should be subject to GST (unless an exemption or zero rate applies). However, when all assets constituting a business are

[275] Singapore GST Act, § 33(4).
[276] Malaysia GST Act, § 65(1) and 65(2).
[277] Malaysia GST Act, § 65(3).
[278] IMF Model Law, § 86(1).
[279] Irish VAT Act, §§ 19(b) and 22(1).

transferred and that business is to be carried on by the purchaser, the cash flow burden arising from the purchaser having to pre finance the GST in respect of the purchase while awaiting the processing of an input tax claim can be unduly burdensome. Consequently, many jurisdictions provide a relief mechanism in the case of a transfer of a business as a going concern for GST purposes (TOGC), where specific conditions are met.

Leading Practice

The GST law should include a provision regarding the GST treatment of a transfer of a business as a going concern, which should include the following:

- The transfer of a business as a going concern may qualify as a zero-rated transaction.
- A supply may be treated as a going concern provided that all the following conditions are met:
    - There should be a transfer of all goods and services necessary for the continued operation of a business or part of business;
    - If only part of the business is transferred, then that part of the business should be capable of separate operation;
    - The transferee should be a registered person; and
    - The transferor and transferee should agree in writing that the supply is a going concern.

Discussion

In New Zealand, "going concern" is defined as a supply of a taxable activity, or of a part of a taxable activity where that part is capable of separate operation, where all of the goods and services that are necessary for the continued operation of that taxable activity, or that part of a taxable activity, are supplied to the recipient; and the supplier carries on, or is to carry on, that taxable activity or that part of a taxable activity upto the time of its transfer to the recipient.[280] The supply of a "going-concern" is explicitly treated as a taxable supply, but is zero-rated for GST purposes if:[281]

- the supplier and the GST registered recipient agree, in writing, that the supply is to be a supply of a going concern; and
- the supplier and the GST registered recipient intend that the supply is of a taxable activity, or part of a taxable activity, that is capable of being carried on as a going concern by the recipient.

Singapore also provides a special rule for TOGC, but takes a different approach to that of New Zealand. A transfer of a going concern is neither a supply of goods nor a supply of services, thus taking the transfer outside of the scope of the tax.[282]Any input tax incurred in relation to the TOGC remains deductible for both transferor and transferee.[283] The transferee who receives such a transfer of assets shall be deemed to have incurred input tax on the value of the assets supplied to him, and to have deducted such deemed input tax from any output tax due from him on the day the supply is made. This is to facilitate any subsequent change of use adjustments.

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[280] New Zealand GST Act, § 2.
[281] New Zealand GST Act, § 11(1)(m).
[282]Goods and Services Tax (Excluded Transactions) Order.
[283] Inland Revenue Authority of Singapore, E-Tax Guide – Transfer of Business as a Going Concern, p. 6.

In order for a supply to qualify as TOGC, the following conditions must be met:

- the supply of assets is made in relation to a transfer of the business or part thereof to the transferee;
- the assets to be transferred must be intended for use by the transferee in carrying on the same kind of business as the transferor. For example, the transferor acquiring a rental business should continue with the transferred tenancies and not terminate them so as to put the immovable property to another use;
- in the case where only part of the business is transferred, that part must be capable of being operated independently;
- the business or part thereof must be a going concern at the time of the transfer;
- the transferee must be a GST registered taxable person at the time of the transfer; and
- both the transferor and transferee must maintain sufficient records on the transferred assets.

Singapore also has additional requirements where the transferee is a member of a GST group.

Malaysia takes a similar approach to Singapore.[284]Under the Malaysian GST Act, the transfer of a business can be considered as a transfer of going concern if:

- the transferor is a taxable person;
- the transferee is a taxable person or will be a taxable person after the transfer of business;
- the transfer of the business must be accompanied by a transfer of business assets that will be used to carry on the same kind of business; and
- if only part of the business is transferred, then that part of the business must be able to operate separately.

The IMF takes a similar approach to New Zealand as the transfer of a business as a going concern is also a zero-rated transaction.[285] There is a transfer of going concern where:[286]

- all the goods and services necessary for the continued operation of that taxable activity or part of a taxable activity are supplied to the transferee; and
- the transferor carries on, or is carrying on, that taxable activity or that part of a taxable activity up to the time of its transfer to the transferee.

In Ireland, similar to Singapore and Malaysia, the transfer of ownership of goods and intangible assets such as goodwill, in connection with the transfer of a business or part thereof to another person is deemed not to be a supply of goods.[287]The current legislation does not expressly state that it is necessary that the business be sold as a going concern. It states that the transferred assets should constitute an undertaking, or part of an undertaking, capable of being operated on an independent basis.

All comparable jurisdictions include a specific TOGC provision for the reasons discussed above in the Overview of Concept section.

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[284] Malaysia GST Act, Third Schedule.
[285] IMF Model Law, Schedule I.
[286] IMF Model Law, §§ 4(2) and (3).
[287] Irish VAT Act, §§ 20(2)c) and 26.

While New Zealand and the IMF consider a TOGC as a zero-rated transaction, Singapore, Malaysia, and Ireland consider the transfer of a going concern to be out of scope of GST. However, the ultimate effect is the same for all jurisdictions.

The GST law should identify what types of transactions qualify as going concerns. All comparable jurisdictions take similar approaches with regard to the conditions that should be met to treat the transfer of a business as a TOGC. Therefore, based on the comparable jurisdictions a transfer of a business should be treated as a TOGC and subject to GST relief where the following conditions are met:

- There should be a transfer of all goods and services necessary for the continued operation of a business or part of business;
- If only part of the business is transferred, then that part of the business should be capable of separate operation;
- The transferee should be a registered person; and
- The transferor and transferee should agree in writing that the supply is a going concern.

The New Zealand approach of electing to treat this type of transaction as zero-rated is preferred, rather than making it a mandatory treatment, as determining whether all requirements for such treatment are met can be problematic. For certainty purposes, it is advisable that the parties agree in advance that the transfer qualifies as a going concern.

1.A.6 Vouchers

Overview of concept

Vouchers, stamps, coupons, tokens and similar items ("vouchers") are generally instruments which give the holder a right to goods or services, or to receive a discount or rebate in relation to a supply of goods or services.[288]

Vouchers create unique challenges from a GST perspective as a voucher is generally involved in two transactions:

1. The supply of the voucher itself (which could be free or for consideration);
2. The redemption of the voucher for goods or services.

The question that arises from a GST perspective is whether to tax the issuance of the voucher or the redemption of the voucher. In order to provide certainty and ensure there is no double taxation or non-taxation, special rules are generally required for the GST treatment of vouchers.

Further, issues can arise in respect of how the value of the transaction should be determined. For example, vouchers may be sold for less than their redemption value or they may be sold through a supply chain involving many parties with each party making a profit on their respective sales. Finally, vouchers could be issued for a specific good or service or for multiple types of

[288]Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of vouchers, 10/5/2012 at page 2.

goods or services that may have different GST treatments, therefore creating issues with determining the correct treatment if the voucher is to be taxed upon issuance.

Leading Practice

The GST law should include a provision regarding the GST treatment of vouchers, which should include the following:

- The issuance of a voucher, stamp, coupon, or token against consideration should not be considered a supply of goods or services if the consideration received for the voucher, stamp, coupon, or token is less than, or equal to, the face value of the voucher, stamp, coupon, or token.
- In cases where the consideration received for the issuance of the voucher, stamp, coupon, or token exceeds the face value of the voucher, stamp, coupon, or token:
    - GST should be applicable at the time of the supply of the voucher, stamp, coupon, or token;
    - The taxable amount should correspond to the difference between the consideration received and the face value of the voucher, stamp, coupon, or token.
- The supplier of goods and services should be required to include in the valuation of the goods and services supplied the value of the voucher, stamp, coupon, or token redeemed.

The above leading practice addresses the basic application of the GST law to the issuance and redemption of vouchers. The treatment of vouchers is an extremely complex area from a GST perspective. During the drafting of the GST law, special attention should be given to the following more complex matters:

- reimbursements where the issuer of the voucher is a different person from the person accepting the voucher and any associated GST adjustments;
- the treatment of markups made by resellers in the supply chain;
- loyalty programs and discount vouchers; and
- distinction between vouchers and payment instruments.

When drafting the law relating to vouchers, reference should be made to the current European Commission discussion on VAT reform in respect to vouchers.[289]

Discussion

In New Zealand, the issue or sale of a token, stamp, or voucher is treated as a supply of goods and services, other than those issued for no consideration.[290]

To prevent a double imposition of GST, the following are not treated as a supply of goods and services:[291]

- goods and services supplied pursuant to the redemption of the token, stamp or voucher; and

[289] Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of vouchers

[290] New Zealand GST Act, § 5(11E).

[291] New Zealand GST Act, § 5(11EA) and (11F).

- the supply of a token, stamp, or voucher by a registered person to another registered person, who subsequently issues or sells the token, stamp, or voucher (unless the first mentioned registered person is the person who actually supplies the goods and services upon the redemption of the token, stamp, or voucher).

However, if the voucher has a face value and it is not practical for the supplier to treat the issue or sale of the token, stamp, or voucher as a taxable supply, then the supplier may treat the redemption of the voucher as the supply of goods and services, rather than the issue of the voucher.[292]

A situation where it may be impractical to treat the supply of the voucher as a taxable supply includes one in which the supplier of the voucher and the supplier of the underlying goods or services may be different. If the issuer of the voucher and the supplier of the goods and services upon redemption of the voucher are different persons, then the issuer and the supplier must agree to this GST treatment.[293]

This elective GST treatment cannot apply to the extent that the consideration received for the supply is more than the face value of the tokens, stamps or vouchers.

Singapore takes a different approach and differentiates between multi-redemption vouchers (MRV) and non-multi-redemption vouchers (Non-MRV).[294] However, the Singapore GST law does not use these terms, rather they are terms that have been adopted by the tax administration to assist with the application of the GST rules to vouchers.

Section 35A of the Singapore GST Act provides the Minister with the authority to set rules relating to the taxation of vouchers via the regulations.

Where any voucher is supplied by an issuer for consideration that is equal to or less than the value of the voucher, the supply of the voucher is disregarded for GST purposes.[295] Where the consideration exceeds the value of the voucher, GST is payable on that excess.[296]

For vouchers that are wholly redeemed on a single occasion, GST may be accounted for (at the option of the taxable person) on the value of the voucher or the amount of the consideration received for the voucher (where the consideration received is less than the value of the voucher). If the consideration received for the voucher was equal to, or more than, the value of the voucher, GST must be accounted for on the value of the voucher.[297]

For vouchers that are partially redeemed on more than one occasion, the value of the supply on each such occasion is as follows:[298]

- where the consideration received by the issuer for the voucher was less than the value

[292] New Zealand GST Act, § 5(11G).
[293] New Zealand GST Act, § 5(11G) and (GA).
[294] Inland Revenue Authority of Singapore, IRAS e-Tax Guide – GST Treatment of Vouchers: Sale and Redemption, at 6 (Jan. 15, 2010).
[295] Singapore GST Regulations, Regulation 93B(1)
[296] Singapore GST Regulations, Regulation 93B(2)
[297] Singapore GST Regulations, Regulation 93C(1)
[298] Singapore GST Regulations, Regulation 93C(2)

of the voucher, either of the following at the option of the taxable person:
  - the portion of the value of the voucher being redeemed on that occasion; or
  - the amount of that consideration that is proportional to the value of the voucher being redeemed on that occasion;
- where the consideration received by the issuer for the voucher was equal to or more than the value of the voucher, the portion of the value of the voucher being redeemed on that occasion.

There are also specific rules for accounting for GST on unredeemed vouchers.[299]

Taxable persons can elect to be subject to different rules, upon approval of the Comptroller, to account for GST at the time the voucher is issued.[300] The Comptroller has fairly broad powers in determining what conditions need to be met in order to be subject to these different rules.

The Singapore Tax authority has interpreted these rules as follows.[301]

	Multi-Redemption Voucher ("MRV")	**Non-Multi-Redemption Voucher ("Non-MRV")**
Sale of voucher	Must be sold for a consideration	Need not be sold for a consideration
Types of goods and/or services that can be redeemed	Can be used to redeem a range of goods and/or services. No reference is made to any particular goods and/or services to be redeemed.	Can be used to redeem only specific goods and/or services. Reference is made to the specific goods and/or services to be redeemed.
GST Treatment	Sale of voucher and redemption of goods and/or services are treated as 2 separate supplies. (a) When voucher is sold i. at or below specified value, no GST needs to be accounted for. ii. Above specified value, GST has to be accounted for on the excess payment received. (b) When voucher is redeemed GST has to be accounted for on the value of the redeemed goods and/or services plus any additional payment received.	Sale of voucher and redemption of goods and/or services is treated as a single supply. (a) When voucher is sold GST is to be accounted for at the earlier of when the payment is received or when an invoice is issued. (b) When voucher is redeemed No further GST is accountable unless additional payment is received. If additional payment is received, GST is accountable on that payment amount.
Examples	$10 shopping vouchers, stored value cards, prepaid gaming and galling cards.	Free vouchers, discount vouchers, voucher for a spa treatment and parking coupons.

[299] Singapore GST Regulations, Regulation 93D.

[300] Singapore GST Regulations, Regulation 93E.

[301] Inland Revenue Authority of Singapore, IRAS e-Tax Guide, GST Treatment of Vouchers, 31 December 2013, at p. 1.

Singapore also has specific rules addressing the supply of vouchers by intermediaries and how to account for the margin made by the intermediary on the resale of those vouchers.[302]

The Malaysian law is drafted in a simpler manner in respect of the treatment of vouchers. It simply states that where a right to receive goods or services for a monetary value stated on any token, stamp (other than postage stamp) or voucher is granted for a consideration, the consideration shall be disregarded except to the extent, if any, it exceeds the monetary value.[303]

The tax authority's application of this rule differentiates between monetary and non-monetary vouchers. Monetary vouchers are those vouchers with a face value while non-monetary vouchers are vouchers that entitle the bearer to a specific good or service mentioned in the voucher.[304]

GST is only chargeable on the issue of a monetary voucher to the extent the consideration for the voucher exceeds the value of the voucher. GST is payable when the voucher is redeemed for goods or services.

For non-monetary vouchers, if the non-monetary voucher is issued for consideration, GST is applicable at the time of the supply. However, if the issuance of voucher is for no consideration, there is a distinction between whether the voucher relates to goods or services. If the voucher relates to services, GST is only applicable when the voucher is redeemed. If the voucher relates to goods, then the Malaysian gift rules apply – only if the value of the goods to which the voucher relates is more than RM500 is the issuance of the voucher subject to GST.[305]

The IMF Model Law was followed by the Malaysian law. The wording of the principal provision governing the treatment of vouchers is the same.[306]However, this does not apply to prepaid phone cards.

If the issuance of a voucher results in a taxable supply, the supply takes place when the voucher is issued.[307] The valuation of the taxable supply is in this case equal to the amount by which the consideration exceeds the monetary value of the voucher.[308] Where a voucher is issued without consideration, the supplier of goods or services is required to include the value of voucher in the value of goods and services supplied when the voucher is redeemed.[309]

In Ireland, the sale of vouchers or telephone cards, and similar items (other than vouchers or telephone cards sold to and by taxable persons with a view to their re-sale) is not liable to tax except where, and to the extent that, the consideration paid exceeds the redeemable value.[310]

Where a taxable person supplies a coupon, stamp, telephone card, token, or voucher, which has a redeemable value, to a taxable person with a view to resale, and the supplier promises to

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[302]Singapore GST Regulations, Regulation 93F.
[303] Malaysian GST Law, Third Schedule. §3
[304] Malaysia, GST Tax Guide on Retailing, at 25.
[305] Malaysia, GST Tax Guide on Retailing, at 28.
[306] IMF Model Law, §4(19).
[307] IMF Model Law, § 10(11).
[308] IMF Model Law, § 13(10).
[309] IMF Model Law, § 13(11).
[310] Irish VAT Act, § 43.

subsequently accept that coupon, stamp, telephone card, token or voucher at its redeemable value in full or part payment of the price of goods or services, the supply is treated as a taxable sale. When such coupon, stamp, telephone card, token or voucher is used in payment or part payment of the price of goods or services, its redeemable value is disregarded for tax calculation purposes.[311]As such, where vouchers are issued through a multi-stage supply chain, vouchers are taxed on issuance.

Finally, where a supplier sells a voucher to a buyer at a discount and promises to subsequently accept that voucher at its face value in full or part payment of the price of goods purchased by a customer who was not the buyer of the voucher, and who does not normally know the actual price at which the voucher was sold by the supplier, the consideration represented by the voucher shall, subject to regulations (if any), be the sum actually received by the supplier on the sale of the voucher.

The GST treatment of vouchers is a complex area. It is therefore necessary for the GST law to provide simple and clear rules regarding vouchers in order to avoid any double or non-taxation of the transaction. The comparable jurisdictions take various approaches towards vouchers and, as such, a leading practice cannot be readily determined.

New Zealand's approach departs largely from the approach of the other jurisdictions as vouchers are subject to GST upon issue. This approach can be impractical and therefore New Zealand includes an exception to this rule such as situations when the issuer of the voucher is not the supplier of the goods or services.

All other jurisdictions identify (at least to a certain extent) that the moment of redemption should be the time of supply. This approach should be preferred as it avoids the impracticalities of the New Zealand approach. Singapore and Malaysia consider the type of voucher (i.e., MRV or non-MRV and Monetary or non-Monetary) to determine the tax treatment. While this approach takes into consideration various business models, it adds complexity to the GST law, which should be avoided when introducing a new type of tax. The IMF and, to a lesser degree, the Irish approach constitute a simpler approach with regards to vouchers: (1) vouchers are subject to GST at the moment of redemption regardless of their nature; and (2) only to the extent that the consideration received exceeds the monetary value of the voucher GST is applicable at the moment of sale on the differential amount. This approach first avoids any discussion regarding the specific type of voucher and any issues regarding whether the issuer of the voucher is also the supplier of goods and services. It also covers situations in which the issuer of a voucher receives consideration for the issuance of the voucher.

1.A.7 Gambling

Overview of concept

Gambling constitutes a specific challenge for the design of a GST law as it is necessary to determine if there is a supply in the first instance and, if there is a supply, when the supply

[311] Irish VAT Act, § 43.

takes places for GST purposes and on what value the GST should be levied. Due to these complexities, historically, gambling fell into the exempt supplies category. However, many of the more modern GST regimes have developed mechanisms to effectively bring gambling within the scope of GST.

Leading Practice

The GST law should include a provision regarding the GST treatment of gambling activities, which should include the following:

- The placing of any amount by a person with another person for betting, sweepstakes, lotteries, gaming machines, or games of chance should be a supply of services by the person operating the betting, sweepstakes, lotteries, gaming machines, or games of chance.
- The time of the supply should be determined as follows:
    - Casino gambling: when the casino count takes place;
    - Slot machines: when the money is removed from the machine;
    - Horse racing and other sports betting: when the bet is received;
    - Prize draws and lotteries: when the draw takes place.
- The value of the supply should be:
    - the amount paid for participating in the betting, sweepstakes, lotteries, gaming machines, or games of chance less.
    - any amount of money payable to any person participating successfully in the betting, sweepstakes, lotteries, gaming machines, or games of chance;
- Any negative value shall be treated as nil for the purpose of the current taxable period and be allowed to be carried forward to a subsequent taxable period.

Discussion

In New Zealand, payments in relation to the following are treated as payments for a supply of services by the person organizing the gambling or betting: racing or sports betting, participation in gambling or prize competitions, and casino gambling.[312]

Where there is a deemed supply by a racing board, the time of supply is deemed to occur when and to the extent that any amount of money is dealt with by the board.[313] For gambling or prize competitions, other than casino gambling, the time of supply occurs when the draw is made.[314] However, this rule does not apply to an instant game played by way of a machine (i.e., slot machines). In that case, the time of supply is deemed to occur when the coin or token is taken from the machine by the supplier.[315] For casino gambling, the time of supply occurs at the time of the "casino count."[316]

The value of the supply of services for racing betting or sports betting is the amount received by the New Zealand Racing Board plus the return of bets laid off by the New Zealand Racing Board less the sum of refunds and winning dividends.[317] The value of the supply of services for equalizer

[312] New Zealand GST Act, § 5(8) to (11C).
[313] New Zealand GST Act, § 9(2)(d).
[314] New Zealand GST Act, § 9(2)(e).
[315] New Zealand GST Act, § 9(2)(f).
[316] New Zealand GST Act, § 9(2)(g).
[317] New Zealand GST Act, § 10(12).

betting is the amount received by a racing club. For gambling and prize competitions, other than casino gambling, the value of the supply is the total consideration paid in money by a recipient to participate in gambling to a supplier less the total amount of prizes paid in money by the supplier.[318] If the gambling is in a casino venue, then the value is the amount of money paid to the casino for a chip, as commission, or to otherwise participate in gambling less any amount paid out by the casino as winnings.[319]

Singapore includes a separate section for betting, sweepstakes, lotteries and gaming under the Special Cases part of the legislation. This section states that the Minister may, by regulations, make provisions modifying the GST rules for transactions involving betting, sweepstakes, lotteries, fruit machines or gaming.[320]

Part XIII of the Singapore GST regulations addresses betting and gaming. The Singapore GST regulations state that where any person pays an amount in money to participate in any transaction involving betting, sweepstakes, lotteries, fruit machines or games of chance, the amount of money so paid shall be treated as consideration for a supply of services to him.[321]

For any gambling supply made outside of a casino, the tax base is equal to the amount paid for participating in the gambling transaction less any amount of money payable to any person participating successfully in the gambling.[322]

In respect of casinos, a casino operator shall be treated as having made a taxable supply of services when a person pays an amount in money to a casino operator as a bet received and accepted by the casino operator as a wager on any game where the casino operator is a party to a wager; or to participate in any game where the casino operator is not a party to a wager but the game is conducted by on the premises of the casino operator.[323]

Casino supplies are deemed to be made at the end of the prescribed taxable period in respect of which the net win from that supply is included in determining the gross gaming revenue of the casino operator.[324]

The tax base is calculated based on the same principles as for gambling supplies made outside of a casino. In addition, the regulation provides special rules for complementary chips or coupons given by the casino operator and bad debts resulting from gambling supplies. Further, any casino loss maybe carried forward and offset against the supplies made in a subsequent period (i.e., where amounts paid out exceed amounts received).[325]

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[318] New Zealand GST Act, § 10(14).
[319] New Zealand GST Act, § 10(15A).
[320] Singapore GST Act, § 35.
[321] Singapore GST Regulations, regulation 91.
[322] Singapore GST Regulations, regulation 91-91B.
[323] Singapore GST Regulations, regulation 92C.
[324] Singapore GST Regulations, regulation 92C.
[325] Singapore GST Regulations, regulation 92E.

Finally, the GST Act provides that any betting, sweepstake, and lottery duties must be included in the value of the gambling supply.[326]

Malaysia adopts a similar position as New Zealand and Singapore in determining the value of the betting and gaming supplies. According to the Third Schedule of the GST Act, the value of taxable supplies of services made by a person licensed under any written law involving betting sweepstakes, lotteries, gaming machines or games of chance must be the amount received by the supplier less any winnings paid out to the betting participants.

The GST Regulations provide further details on the time of supply of gambling and similar activities:[327]

- Where there is a supply of services involving number forecasting, lottery and a game of chance, the time of supply is at the time when the numbers are drawn.
- Where there is a supply of services involving sweepstakes, the time of supply is at the time when the race is taking place.
- Where there is a supply of services by gaming machine, the time of supply is at the time when collection is removed from the machine, or at the time when transaction is recorded by the machine; or
- Where there is a supply of services involving casino betting, the time of supply is on the last day of the taxable period in which the supply takes place.

Under the IMF Model Law, the placing of a bet by a person with another person operating a game of chance is a deemed to be a supply of services by the person operating the game of chance.[328] The time of supply for games of chance is subject to the general rules; i.e., earliest of performance of service, date of invoice, or payment.[329] However, if the supply for consideration in money is received by the supplier by means of a machine, meter, or other device operated by coin, note, or token, the time of supply occurs when the coin, note, or token is taken from the machine, meter, or other device by or on behalf of the supplier.[330] The value of a supply of games of chance is the amount received in respect of the bet, reduced by an amount equal to the tax fraction multiplied by the amount received in respect of the bet.[331] Unlike the other jurisdictions discussed above with value the supply as being net of any payments made to winning gamblers or participants, the IMF Model Law allows a specific input tax deduction for payments as a prize or winnings.[332]

Ireland departs from the approach followed by all the other comparable jurisdictions and exempts gambling and lotteries.[333]

Based on the comparable jurisdictions, leading practice is to tax gambling transactions. Therefore, the Irish approach should be excluded. Specific valuation rules and time of supply rules should

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[326] Singapore GST Act, Third Schedule.
[327] Malaysia GST Regulations, Regulation 13.
[328] IMF Model Law, §4(9).
[329] IMF Model Law, §10(1).
[330] IMF Model Law, §10(7).
[331] IMF Model Law, §13(15).
[332] IMF Model Law, § 27(d).

[333] Irish VAT Act, Schedule 1.

be adopted to reduce the compliance burden associated with calculating GST on a per supply basis.

1.A.8 Non-resident GST refunds

Overview of concept

There may be situations where non-resident taxable persons who are not GST registered, nor are required to be GST registered, in a jurisdiction incur GST in that jurisdiction. Such GST costs can arise in a number of ways, including:

- Employees traveling to that jurisdiction and incurring GST on hotel, rental cars and other travel expenses;
- The non-resident imports goods into the jurisdiction and incurs import GST;
- The non-resident is charged GST by a resident supplier (e.g., services related to land in Puerto Rico).

Countries adopt various approaches to address such GST incurred by foreign entities, including:

- Providing simplified refund procedures to allow these entities to recover any GST incurred where that non-resident taxable person would have been entitled to recover the GST if it was operating its business in that country (e.g., European Union);
- Allowing the non-resident to register for GST and file returns to recover the GST incurred where that non-resident taxable person would have been entitled to recover the GST if it was operating its business in that country (e.g., Australia and New Zealand);
- Not permitting the recovery of the GST incurred unless the non-resident taxable person is making supplies subject to GST in that country (e.g., Singapore).

The general rationale for allowing non-resident businesses to recover GST incurred on costs is that GST should not be a cost to business; it is a tax on final consumption.

Many jurisdictions that allow GST refunds to non-resident businesses often place certain limitations on those refunds. For example, refunds may not be permitted unless the business's country of residence also provides refunds to non-resident business or refunds may not be permitted in respect of goods or services consumed in the country, such as food and accommodation.

Another situation giving rise to non-residents incurring GST is that of purchases made by tourists.

Many jurisdictions allow tourists to recover GST incurred on purchases made in the jurisdiction provided the purchases are removed from the country when the tourist leaves the country. The rationale behind such an approach is that GST should only apply to goods or services consumed in the GST jurisdiction. If a tourist purchases a souvenir to take back to their home country, consumption of that good arguably occurs in the tourist's home country.

Leading Practice

The GST law should include a provision regarding non-resident GST Refunds, which should include the following:

- Non-resident taxable persons, which are not registered under the general registration rules, that incur GST in Puerto Rico on purchases of goods and services for their taxable activity abroad may be permitted to register for GST and claim a refund of input GST under the following conditions:
    - Registration:
        - The non-resident is registered for a consumption tax similar to Puerto Rico's GST or carries out an activity that would cause the non-resident to be registered for GST if the activity was carried out in Puerto Rico;
        - The non-resident does not carry on or intend to carry on a taxable activity in Puerto Rico;
        - The non-resident does not sell goods or services that it can reasonably foresee will be received by an unregistered person in Puerto Rico.
    - Refund of input GST:
        - A non-resident registered for GST under the above conditions should be required to file a GST return on a calendar quarter basis;
        - Any amount of input GST that during a calendar quarter does not exceed a certain dollar value threshold should be carried forward to the next calendar quarter;
        - Any amount of GST during a calendar quarter that exceeds a certain dollar value threshold should be refunded to the non-resident within a prescribed number of days following the day the GST return was filed.

The GST law should also provide a refund of GST for tourists visiting Puerto Rico who purchase goods in Puerto Rico during their stay which they subsequently take back to their home countries.

Discussion

Refunds for non-resident businesses

In New Zealand, a non-resident can voluntarily register for GST even where the non-resident does not make taxable supplies in New Zealand.[334] A non-resident may only register if the following conditions are met:

- The non-resident is likely to claim an input tax deduction of more than NZD 500 in the first taxable period after registration;
- The non-resident is registered for a consumption tax in its country or carries out an activity that would cause him to be GST registered if the activity was carried out in New Zealand;
- The non-resident does not carry on or intend to carry on a taxable activity in New Zealand;
- The non-resident does not perform services that it can reasonably foresee will be received by an unregistered person in New Zealand; and
- The non-resident is not and does not intend to become a member of a group of companies that carries on a taxable activity in New Zealand.

GST is refunded within 90 working days of receiving the registered person's return.[335]

[334] New Zealand GST Act, § 54B.

[335] New Zealand GST Act, § 46.

In order to facilitate the claiming of a refund under the law, special rules are included in the section addressing the calculation of tax payable to allow the non-resident to claim GST that has been incurred despite the fact this it is not making supplies subject to New Zealand GST.[336]

Malaysia, Singapore and the IMF do not have general non-resident refund rules. Singapore has a limited refund rule for GST incurred on the importation of goods, subject to certain conditions.[337]

Ireland has a simplified regime for non-resident business to claim VAT incurred in Ireland. This regime does not involve the non-resident registering for VAT but allows the non-resident to file a refund claim by supplying certain required supporting documentation.[338] The VAT incurred must relate to the business carried on by the non-resident and the non-resident must not be making supplies of goods or services in Ireland.

In order to promote fairness and neutrality of the tax, the GST law should allow non-residents to recover input GST where is it incurred for the purposes of its business activity, if that activity would be taxable if carried on in Puerto Rico. For Puerto Rico, the New Zealand approach of requiring the non-resident to register for GST is preferable over the simplified approach of Ireland, in order to reduce the opportunity for fraud.

Tourist refunds

All comparable jurisdictions, except New Zealand, allow to a certain extent a refund of GST paid by tourists on purchases of goods made in the jurisdiction during their stay, which they bring back to their jurisdictions.

In order to maintain Puerto Rico's competitiveness in the tourism sector, GST refunds for goods purchased by tourists that are removed from Puerto Rico upon the tourist's departure should be provided.

1.B General Provisions

1.B.1 Document retention

Overview of concept

In order to facilitate the efficient assessment and enforcement of the tax by the tax authorities, the GST law should prescribe document retention rules. The provision should describe what type of documents should be retained, for how long, where and in what format (e.g., electronic or hard copy). Special rules should be included in the GST law as documents supporting GST positions taken can differ from those documents used for income tax assessment purposes. For example, there may be certain GST specific regimes, or transactions with a greater GST risk that require specific types of documents to be maintained (e.g., import documentation, documentation relating to transfers of going concerns, GST invoices and adjustment notes).

[336]New Zealand GST Act, § 20.
[337]Singapore GST Act,§ 33A.
[338] Irish VAT Act, § 102.

Consideration should be given to the compliance burden and associated costs placed on taxable persons with regard to record storage and this should be balanced against the tax risk, as well as the statute of limitations relating to tax reassessments.

The rules should also address tax authority access to the records.

Leading Practice

The document retention rules should be drafted to include the following:

- All taxable persons must maintain the following records:
  - All original invoices, credit notes, and debit notes received;
  - Copies of all invoices, credit notes, and debit notes issued;
  - Customs documentation relating to the import and exports; and
  - Business and accounting records (e.g., contracts, sales and purchase registers. Books, bank statements).
- The records must be retained for a certain defined period of years from the end of the taxable period to which they relate. The number of years should be consistent with other tax and accounting rules in Puerto Rico.
- Records may be kept in a foreign jurisdiction upon tax authority approval or subject to certain guidelines such as accessibility.
- Records may be kept in electronic format provided that there are controls to guarantee the authenticity of the origin of the documents and maintain the integrity of the content of the document.
- The taxable person must be able to produce any requested records to the tax authority within a reasonable timeframe.

Discussion

Under the New Zealand GST Act, a GST registered person must keep records that are sufficient to enable ready ascertainment by the tax authority of that person's liability to tax for a period of at least seven years after the end of the taxable period to which they relate.[339]

The law provides a non-exclusive list of records that should be kept, including books of account recording receipts or payment or income or expenditure, vouchers, bank statements, invoices, tax invoices, credit notes, debit notes, receipts, and such other documents necessary to verify the entries in the books of account.[340]

Those records should contain at least (1) a record of all goods and services supplied by or to that registered person allowing the Commissioner to identify the goods and services, and the suppliers or the their agents; (2) the charts and codes of account, the accounting instruction manuals, and the system and program documentation; and (3) any special list required to be prepared under the GST Act.

The New Zealand GST Act also includes special record keeping rules in relation to certain supplies of land, and powers for the Commissioner to extend the record keeping period for an additional three years if the taxpayer is under audit or will likely be under audit.

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[339] New Zealand GST Act, § 75(3).

[340] New Zealand GST Act, § 75(1).

The records must be maintained in New Zealand unless the registered person has been authorized by the Commissioner to keep the records outside of New Zealand.[341]

In Singapore, every taxable person is required to keep the following records for a period of five years from the end of the prescribed accounting period to which the record relates: (1) business and accounting records; (2) copies of all tax invoices and receipts issued by the taxable person; (3) tax invoices received by the taxable person; (4) documentation relating to importations and exportations by the taxable person; and (5) all credit notes, debit notes or other documents which evidence an increase or decrease in consideration that are received, and copies of all such documents issued by the taxable person.[342] The records can be kept in electronic format.

The Comptroller has the power to prescribe additional record keeping requirements by regulation.

In Malaysia, every taxable person is required to keep full and true records of all transactions which may affect his liability to tax including (1) all records of goods and services supplied by or to that taxable person including tax invoices, invoices, receipts, debit notes, credit notes, and export declaration forms; (2) all records of importation of goods; and (3) all other records required by the tax authority.[343] The records must be kept in Malaysia, unless record storage outside of Malaysia has been approved, and must be kept for a period of seven years.[344] The records can be kept in electronic format provided that the original document was an electronic document.[345]

Under the IMF Model Law, every taxable person is required to maintain in the jurisdiction (1) original tax invoices, tax credit notes, and tax debit notes received by the person; (2) a copy of all tax invoices, tax credit notes, and tax debit notes issued by the person; (3) customs documentation relating to imports and exports by the person; (4) accounting records relating to taxable activities carried on in the jurisdiction; and (5) any other records prescribed by regulations.[346] Records must be retained for six years after the end of the taxable period to which they relate.[347] The law defines records as meaning accounting records, accounts, books, computer-stored information, or any other document.[348]

The Irish VAT Act provides that every taxable person must, in accordance with regulations, keep full and true records of all transactions which affect or may affect his liability to tax and entitlement to deductibility for a period of six years from the date of the last transaction to which they refer.[349]

The basic records to be maintained by businesses (large and small) are essentially the same and, in brief, include invoices, credit notes, debit notes, receipts, books, bank statements or other

[341] New Zealand GST Act, § 75(3BA)(b).
[342] Singapore GST Act, § 46(1).
[343] Malaysia GST Act, § 36(1).
[344] Malaysia GST Act, § 36(2).
[345] Malaysia GST Act, § 36(3).
[346] IMF Model Law, § 61(1).
[347] IMF Model Law, § 61(2).
[348] IMF Model Law, § 60.
[349] Irish VAT Act, § 84(1).

documentation that relates to the supply of goods or services, importation or intra-community acquisition of goods.

The Irish VAT Act is much more prescriptive than the other jurisdictions and also includes specific record keeping rules for certain types of transactions that have a special treatment under the Irish VAT Act.[350]

All comparable jurisdictions include a specific provision detailing the recordkeeping requirements for GST purposes. The common theme of these rules is that all records that enable the tax authority to validate the tax position taken by the taxable person must be kept for a certain period, varying between five and seven years.

Based on the comparable jurisdictions, it is leading practice to include specific record keeping rules in the GST law which will facilitate the inclusion of GST specific record keeping rules relating to GST specific regimes, where required. Taxable persons should be required to keep all invoices, credit and debit notes relating to input and output transactions. In addition, taxable persons should also keep customs documentation relating to import and export transactions performed. Finally, taxable persons should be required to maintain accounting records.

The length of time records should be maintained should be in line with other tax and accounting rules in Puerto Rico.

In order to minimize compliance costs, taxable persons should be permitted to maintain records electronically and in a foreign jurisdiction, subject to the tax authority's approval or guidelines.

1.B.2 Currency

Overview of concept

Transactions with non-resident businesses may occur in foreign currencies. Exchange rate variations may thus create valuation distortions between the value of the supply at the time of supply and when the supply is reported.

Further, where domestic transactions between businesses are conducted in a foreign currency, if the supplier uses a different exchange rate to that of the purchaser, there can be a variance between the output tax reported by the supplier and the input tax claimed by the purchaser, potentially resulting in a cost to the government.

GST laws thus generally include a provision dealing with foreign currency transactions.

Leading Practice

[350] Irish VAT Regulations, regulation 27.

The currency rule should be drafted as a separate provision and include the following:

- All amounts under the GST law should be expressed in US dollars with the exchange rate applicable at the time of supply used for currency conversion.
- A power for the tax authority to determine other currency conversion methods that may ease the administrative burden of the taxable person.

Discussion

In New Zealand, for transactions under the NZ GST Act, all amounts of money must be expressed in New Zealand dollars.[351] As such, GST invoices are required to be issued in New Zealand dollars, thus ensuring that the output tax reported by the supplier is the same as the input tax claimed by the purchaser. The exchange rate should be the prevailing rate at the time of supply.

In Singapore, where a value is expressed in a currency other than Singapore dollars, it must be converted into Singapore dollars at the prevailing selling rate at the time of supply.[352] The Comptroller can also publish rates of exchange that may be used or determine other accepted methods for currency conversion. The use of alternative methods is generally subject to Comptroller approval.

Malaysia adopts a similar approach to Singapore.[353] The use of the following exchange rates corresponding to the time of supply is acceptable:

- In the case of domestic transactions, the use of daily exchange rates (buying, selling or average of the two) of any bank operating in Malaysia.
- In the case of the importation of goods, conversion of foreign currency should be at the exchange rates published by Customs which are updated every week.[354]

Under the IMF Model Law, all amounts of money are to be expressed in the local currency.[355] If an amount is expressed in a foreign currency, the amounts must be converted at the exchange rate determined in the customs act for imports and at the exchange rate applying at the time the amount is taken into account under the Act – effectively the time of supply.[356]

Ireland requires that the amount of VAT included on a tax invoice must be expressed in Euros.[357] Where a currency other than Euro is used, it must be converted into Euro. The exchange rate to be used must be:[358]

- The latest selling rate recorded by the Central Bank of Ireland or the European Central Bank for the currency in question at the time the tax becomes due, if no agreement has been reached with the Revenue as to the basis for determining the exchange rate;
- If there is an agreement with the Revenue for a method to be used in determining the exchange rate, the exchange rate under that method.

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[351] New Zealand GST Act, § 77.
[352] Singapore GST Act, Schedule 3, §11(1)
[353] Malaysia GST Act, Third Schedule – Value of Supply of Goods or Services.
[354] Malaysia GST Guide, Tax Invoice and Record Keeping (DRAFT), at 24.
[355] IMF Model Law, § 83(1).
[356] IMF Model Law, § 83(2).
[357] Irish VAT Regulations, regulation 10.
[358] Irish VAT Act, § 37(4).

All comparable jurisdictions include a specific provision in respect of currency conversion in order to provide certainty in respect of how foreign currencies are to be converted and to ensure there are no mismatches between what output tax is paid by a supplier and what input tax is claimed by a purchaser. Given the compliance burden associated with monitoring foreign exchange rates, some jurisdictions allow the use of methods other than daily exchange rates (e.g., mid-month or month end rates, rates to be renewed every three months). These concessions are usually provided as an administrative relief and not included under the law, other than providing the tax authority with the power to prescribe other methods.

The location of the currency provision within the law also varies with some jurisdictions including the provision with the valuation sections (Singapore, Malaysia and Ireland) and others having a separate currency provision (New Zealand and the IMF).

Leading practice would be to include a currency provision to avoid the issues discussed above. For simplicity it should be included as a separate provision, similar to the IMF and New Zealand law. All amounts under the GST law should be expressed in US dollars with the exchange rate applicable at the time of supply used for currency conversion. The section should also include a power for the tax authority to determine other currency conversion methods that may ease the administrative burden of the taxable person.

1.B.3 Language

Overview of concept

In order to facilitate the administration of the tax, GST laws generally provide that records must be maintained in the local language. Some jurisdictions allow records to be maintained in another language provided that a translation can be made readily available upon the request of the tax authority. Such a provision is especially important for non-resident taxable persons that may not use the language commonly spoken in the GST jurisdiction in their day to day accounting system.

Leading Practice

The language provision should be drafted to include the following:

- Records should be maintained in Spanish or English.
- Taxable persons may apply to the tax authority for permission to maintain records in a language other than Spanish or English.

Discussion

In New Zealand, the Tax Administration Act requires that records to be kept in English. However, the tax authority may approve records to be kept in a foreign language upon request.[359]

Singapore and Ireland do not include any specific requirement regarding language in their legislation.

[359] NZ GST Act, § 75(3BA)

In Malaysia, all records regarding the supply of goods and services must be kept in Bahasa Malaysia or in the English language.[360]

The IMF Model Law states that where records are not kept in the national language, the Commissioner may require the person keeping the record to provide, at that person's expense, a translation into the national language by a translator approved by the Commissioner.[361]

The Malaysian approach to require recordkeeping in a specific language should not be followed as it may be impractical for non-residents, especially those only registered for GST refund purposes. The IMF and New Zealand provide the leading practice in respect of language requirements, with the IMF being less stringent than New Zealand by not requiring the taxable person to obtain prior approval to keep the records in another language but by requiring a translation of the documents upon the tax authority's request.

In order to provide some control over the languages that are acceptable for record keeping, the law should require the records be maintained in Spanish or English language. Should a taxable person wish to maintain records in another language, the taxable person should apply to the tax authority for such permission. Approval of such applications should be dependent upon the language and whether the tax authority is satisfied that translated documents could be provided by the taxable person in a timely manner.

1.B.4 Additional issues to consider

Enactment of the tax and supplies spanning rate and rule changes

The enactment of the tax and supplies spanning rate or rule changes may affect agreements or contracts that span the enactment, rate, or rule change. GST laws may change over time to adapt to the revenue needs of the government or to address social issues. The changes generally involve rate increases or decrease, or changes in the treatment of particular types of supplies (e.g., change the treatment from taxable to exempt or vice versa). Therefore, GST laws generally provide for specific rules dealing with the transition period between old and new rules.

Secondhand goods

Taxable persons selling secondhand goods are required to charge GST their sales like any other taxable person. However, where they acquire those secondhand goods from non-registered persons, GST is likely to be imbedded in the cost of that acquisition as a result of the GST that was paid by the non-registered person on the initial acquisition of the good. In order to prevent GST being levied twice on the same good, jurisdictions adopt different approaches. One approach is to apply a margin scheme for such dealers in secondhand goods so that only the margin is subject to GST. Another approach is to allow a notional input tax credit on the acquisition of the second hand goods from non-registered persons. The GST law should include rules governing sales and purchases of second hand goods.

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[360] Malaysia GST Act, § 36(2)(b).

[361] IMF Model Law, § 63.

Domestic Reverse Charge

Some countries apply the reverse charge mechanism on certain limited domestic transactions either to avoid additional administrative burden on taxable persons (e.g., cash flow burden arising from high value domestic transactions) or to combat tax fraud and evasion (e.g., in industries where refund fraud is more likely). Introducing a domestic reverse charge results in the recipient of the supply accounting for both the input and output tax on the transaction, therefore eliminating any cash flow burden arising from the transaction for the parties involved and any risk of a fraudulent refund payment being made by the tax authority. Consideration should be given as to whether any industries in Puerto Rico would warrant such treatment.

Agents for non-resident principals

Many jurisdictions have specific rules around agents being liable for the GST payment and compliance obligations of non-resident principals. Some jurisdictions require the appointment of a fiscal representative at the time of the registration of the non-resident, while others include a deeming provision within the law which states that an agent carrying on an activity for and on behalf of a non-resident is liable for the non-resident's GST obligations. Consideration should be given as to whether Puerto Rico should adopt a similar approach.

Electronically supplied services by non-residents

"Electronically supplied services" (ESS) are generally services that are:

- Delivered over the Internet or an electronic network (in other words reliant on the Internet or similar network for its provision);
- Heavily dependent on information technology for their supply (in other words the service is essentially automated, involving minimal human intervention and in the absence of information technology does not have viability).

Examples of ESS include digital books, downloaded music and videos, webhosting, online storage, software, apps, etc.

Most GST jurisdictions do not tax services supplied by an overseas supplier to an end customer over the internet if the supplier has no presence in that jurisdiction. However, there are special rules in the EU, Switzerland, Norway, Iceland, South Africa, and Ghana that require the providers of electronically supplied services to account for GST on sales to private consumers and non-taxable entities (e.g. public schools) in these territories (collectively B2C supplies), regardless of the absence of any local presence. B2B supplies are generally not subject to these special rules.

The rationale behind this approach is that it creates a level playing field for domestic suppliers of such services and non-resident suppliers given that the consumer can generally obtain such services from anywhere in the world with relative ease. Puerto Rico should consider the application of such a regime.

Appendix E: Goods and Services Tax Exemptions

Appendix E: GST Systems and Exemptions

A universally applicable broad based flat rate GST will be regressive. There are two ways to redress regressivity. The first, adopted by most modern regimes, is through transfer payments to select taxpayers to mitigate the impact of the tax on "necessities." The second, used principally by early adopters, is to provide exemptions or special rates for designated goods or services. Best practice indicates exemptions should be kept to a minimum to reduce the complexity of the administration of the tax.

This paper focuses on the issues associated with GST exemptions noted in our deliverable entitled "Analysis of Current Tax Structure and Optional Tax Strategies." It provides examples of some of the challenges faced by GST regimes that have chosen to use exemptions to address regressivity.

Overview

A single rate, broad based system is preferred because:

- It lowers cost of collection (administration costs for the government and compliance costs for businesses).There are no disputes over which rates should apply to which goods and services nor is there any incentive to fraudulently apply an incorrect rate. Further, accounting processes are simplified because only one rate is required to be tracked.
- A single rate avoids exemption creep and creating political vulnerability from businesses requesting to benefit from a lower rate.
- It eliminates the potential disruption of consumer choices that may arise where multiple rates may create an incentive to purchase lower rated goods and services.
- It minimizes the situations where suppliers will be making exempt supplies and therefore have an incentive to self-supply or vertically integrate because GST charged by third parties is not recoverable.
- It reduces the number of entities that will be making both taxable and exempt supplies requiring them to track and apportion the GST charged on business inputs to ensure only GST related to taxable supplies is recovered. This apportionment is difficult to achieve accurately and disputes can arise between the taxpayers and tax authority regarding the methods used to apportion input tax credits.

In 2007, Copenhagen Economics undertook a study on the application of reduced VAT rates in the European Union.[362]The study found empirical evidence indicating that compliance costs associated with lower VAT rates can be sizeable. It further found that differences in VAT rates between similar products may give rise to a substantial number of administrative and legal conflicts about the proper classification of specific goods.

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[362] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union,* 21 June 2007.

Collection costs are difficult to estimate and data is hard to come by. However, one clear implication of the evidence from developed economies is that the collection costs associated with GST are likely to be significantly affected by the design of the tax.[363] A broad based, single rate tax with a high registration threshold and few exemptions will have relatively low collection costs.

Evidence from New Zealand has shown that while precise administrative costs of GST may be difficult to ascertain, those costs are lowered if a broad based, low rate version of the tax is introduced. New Zealand's GST has had one major policy review since its enactment in 1986, which produced no recommended structural change. The Inland Revenue Department, responsible for most of the legislative work on GST, has the time of just 1½ professional policy staff dedicated to GST out of a total tax policy complement of 45. The key point is the New Zealand GST regime has been low cost from an administrative perspective. This is generally attributed to the twin policy pillars of comprehensive coverage and a single domestic rate.[364]

The study also observed that due to the substantial economic consequences of activities being classified with different VAT rates, businesses and tax authorities are constantly disputing borderline cases. In Sweden, such disputes constitute roughly 1/5 of all cases referred to their tax tribunal, and consuming, conservatively estimated, real resources in the public and private sector of almost US$100 million (Swedish Government, 2005).[365]

The Study also found that even very detailed guidance on the appropriate VAT rates to be applied on each potential food-like product will not prevent a large number of borderline cases being disputed between businesses and tax authorities because having different VAT treatments for goods and services can create considerable incentives for traders to obtain a lower rate for a specific good or service.[366]

Ultimately, the Study found that the income distributional effects of differentiated VAT rates are modest, particularly in countries with a relatively equal distribution of income, relative to the resulting compliance costs and distortions of consumer choice. For countries with less comprehensive transfer systems and more unequal distribution of incomes, the effects are larger. However, in both cases the Study argued that more targeted transfer systems and reduced compliance costs could be attained at lower costs to society.[367]

The Study stressed the need to consider alternatives to lower VAT rates to accomplish the desired policy goals. Targeted subsidies may have smaller mechanical revenue loss and a higher effectiveness.[368]

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[363] Ebrill et al, *The Modern VAT*, International Monetary Fund, 2001.
[364] Ian Dickson and David White, *Tax Design Insights from the New Zealand Goods and Services Tax Model*, Working Paper Series, Work Paper No. 60, Victoria University of Wellington, Apr.2008, p. 7.
[365] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union*, 21 June 2007 at p.53.
[366] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union*, 21 June 2007 at p.71 and 78.
[367] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union*, 21 June 2007 at p.84.
[368] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union*, 21 June 2007 at p. 34.

Mechanical revenue loss arises where GST revenue foregone does not contribute to reaching the desired goal (e.g., GST exemption for food in order to improve the income distribution resulted in mechanical revenue loss because high income households will also benefit from lower GST).[369]

Exemptions and reduced rates can result in significant mechanical revenue loss. In New Zealand, the evidence available at the time suggested that while the bottom 20% of households allocated between 23% and 29% of their budgets to food, the top two deciles spent between 7% and 10% of their budgets on food. However, overall, upper income households spent twice as much as low-income households. Of every NZ$100 spent on food in New Zealand, the least well off spent NZ$6.50, whereas the most well off spent NZ$12. Taxing all food thus made revenue available to redistribute and supplement the income of the poor via other means.[370]

The OECD arrived at the same conclusions in its bi-annual analysis of consumption taxes.[371] The OECD observes that while most countries implement reduced rates and exemptions in order to alleviate the tax burden on low-income households, the benefits are greater for the better off resulting in tax expenditure producing a result that is unlikely to be in line with the original intention.

Given Puerto Rico's current administrative capabilities, a single rate, broad based system would be the best option.

Specific Country Experience - Food

Food exemptions create significant issues in determining whether particular food items fall within the exemption. Further, extensive tax authority guidance is required to help with this classification of food. Even with such guidance, there are often significant economic incentives for taxable persons to push the boundaries of those exemptions and dispute borderline cases.

Also, the exemption of certain food items results in foregone revenue that could be redistributed more effectively. Some of the issues faced by some jurisdictions that have chosen to exempt food are discussed below.

In the UK, basic food products for human consumption are zero rated and Her Majesty's Revenue and Customs ("HMRC") provides complex guidance detailing all the exceptions to zero-rating in the VAT law.

There are a number of exclusions from this treatment, including:

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[369] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union*, 21 June 2007 at p. 6

[370] Ian Dickson and David White, *Tax Design Insights from the New Zealand Goods and Services Tax Model*, Working Paper Series, Work Paper No. 60, Victoria University of Wellington, Apr. 2008, p. 6.

[371] OECD, Consumption Tax Trends 2012: VAT/GST and Excise Rates, Trends and Administration Issues.

- Cold items taken away may be zero-rated in certain circumstances while certain hot food items taken away are standard rated.
- Confectionery is standard rated.
- A supply of food in the course of catering is standard rated.
- Certain beverages are standard rated.

With these exclusions come a number of classification and interpretation issues:

- *Hot vs. Cold takeaway food items*

  In the UK, cold items taken away may be zero-rated in certain circumstances while certain hot food items taken away are standard rated. Disputes have arisen in respect of why food items may be hot when taken away (i.e., are they specifically sold for consumption whilst hot or are they sold hot for another reason?).

  One dispute related to the sale of hot bagels which HMRC sought to tax at the standard VAT rate. However, the taxable person successfully argued that the reason why the bagels were hot when taken away was that they needed to be toasted to create a crunchy interior rather than for consumption whilst hot.[372]

  Another dispute related to heated ciabatta. HMRC argued that the purpose of heating the ciabatta was for the customer to consume the food hot and therefore it should be standard rated. However, the UK VAT Tribunal agreed with the taxable person's argument that the ciabatta was heated to maintain optimum freshness and to create appealing aroma in the shop. The taxable person further argued that it had no interest in, nor control over, the temperature at which the customer chose to consume the product.

- *Confectionery vs. Basic Foodstuffs*

  In the UK, confectionary is standard rated while basic foodstuffs are zero-rated. There have been many disputes of the classification of confectionary resulting in a number of complex tests developed by the courts.

  The courts have found that confectionery is generally held as being any food normally eaten with the fingers and made by a cooking process (other than baking) which contains a substantial amount of sugar or sweetening agent.[373] Further, the courts consider the view of the purchaser, appearance, size, ingredients, manufacturing process, taste, texture, packaging and marketing are relevant.[374]

  These types of tests can obviously be very subjective, giving rise to further disputes as to classification of certain food products.

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[372] *The Great American Bagel Factory Ltd* (VTD 17018) (TVC 29.58).
[373] *Popcorn House Ltd* [1968] 4 All ER 782.
[374] *C & E Commrs v Ferrero UK Ltd*, CA [1997] STC 881 (TVC 29.136).

- *Catering*

The treatment of the supply of food in the course of catering has also been the subject of many disputes.

A supply of food and drink in the course of catering is standard rated. Catering is characterized as a supply involving a significant element of service or the supply of food is for 'on premises' consumption.

Many of the disputes have centered around what should be considered a "significant element of service."

Disputes have also arisen in respect of whether the food is supplied for "on premises" consumption. HMRC considers premises to be the areas controlled by the retailer or areas that have been specifically provided for the customer to consume the food purchased. Similar disputes have arisen in other countries, for example, where seats were provided by the European equivalent of a food truck vendor – does this constitute "on premises" consumption?

- *Drinks*

The classification of beverages is particularly complex in the UK. Beverages are generally standard rated, with the following exceptions:

- Tea, maté, herbal teas and similar products, and preparations and extracts thereof;
- Cocoa, coffee and chicory and other roasted coffee substitutes, and preparations and extracts thereof; and
- Milk and preparations and extracts thereof.

Disputes have not only arisen in respect of whether a beverage falls within one of these exceptions but also whether a drink is a beverage or not.

In respect of the former, the VAT tribunal found that as the drink contained over 50% milk extracts, the drink was able to be zero-rated, even though it did not appear to be a milk based drink.[375]

In respect of the latter, complex tests have been developed through case law to determine whether a drink is a beverage.

The court found in *Bioconcepts* that notwithstanding the Oxford English Dictionary definition of "beverage" meaning drink, it is not used in the sense of meaning all drinkable liquids. Its meaning in ordinary usage covers drinks that are commonly consumed. This concept of what is a commonly consumed beverage was characterized by the courts as:

1. A liquid that is commonly consumed; and a liquid that is characteristically taken to;

[375] *Rivella (UK) Ltd* (VTD 16382) (TVC 29.175).

2. Increase bodily liquid levels;

3. To slake the thirst;

4. To fortify, or;

5. To give pleasure

These five points were adopted by HMRC as being the key factors in determining whether a product is a beverage. They were placed in HMRC guidance through Public Notice 701/14/02 Food (May 2002). Subsequent cases have cited the "Beverage Test" within the decision.

Each of these five points gives rise to its own complexities and interpretation. An example is in respect of increasing bodily fluids. In the case of Unilver Bestfoods UK Ltd the tribunal found that the high sugar content of "Vie Shots" had the effect of slowing the rate of absorption of the product. Vie Shots were therefore not considered suitable for quick hydration of body fluid levels.

Some of the tests are quite subjective, including the fortify and pleasure points. In respect of the fortify point, in the case of *Ocean Grown UK Ltd*, it was noted that to consider whether or not a beverage is fortifying, it is important to look at how the customer perceives the product and what the marketing literature says; it was felt that scientific research is irrelevant.

In Australia, basic food products are GST free. Australia has very comprehensive guidance on food, including an 88 page list of specific food items and their treatment. Further, they have a dedicated Food Classification Working Party to address GST and food issues.

Where a certain food item is not specifically listed, a taxable person needs to work through a complex flow chart to determine whether the food should be subject to GST. This flow-chart includes 12 steps, each giving rise to their own definitional issues.

Not only can disputes arise in respect of the classification of food, as noted in the UK examples, but they can also arise where exempted foods are sold with other products. Such a dispute arose in Australia in respect of a supplier of exempt food who included promotional items with the food, such as radios and alarm clocks. Even though the promotion items were marked as "free," the court held that the amount paid for the exempt food and the promotion item needed to be apportioned between the exempt food and the taxable promotional item.[376]

Where food classification disputes arise, complex analyses of the products are often required. Another Australian case considered whether a mini ciabatte was a cracker.[377] The judge went through the following analysis:

- the ingredients of Mini Ciabatte are substantially the same as those of a cracker;

[376] *Food Supplier and Commissioner of Taxation* [2007] AATA 1550.
[377] *Lansell House Pty Ltd v Commissioner or Taxation* [2010] FCA 329.

- the ratio of ingredients in Mini Ciabatte and crackers are substantially the same;
- the manufacturing processes are largely the same for Mini Ciabatte and crackers;
- both Mini Ciabatte and crackers can be produced using yeast and can include fermentation stages;
- the percentage of sugar as an ingredient of Mini Ciabatte is within the range specified for crackers;
- to the extent that the Italian origin of Mini Ciabatte is relevant, the evidence points towards the product being a cracker;
- Mini Ciabatte and crackers are put to the same use;
- Mini Ciabatte and crackers are displayed in supermarkets as comparable products;
- while the appellants market Mini Ciabatte as Italian flat bread, the supermarkets treat it and sell it either as a cracker or in the company of crackers and biscuits;
- the moisture content of dry flat bread such as Mini Ciabatte is quite low and similar to crackers;
- Mini Ciabatte has an elongated cell structure similar to that of a cracker;
- both Mini Ciabatte and crackers have a gluten network;
- the percentage of protein of Mini Ciabatte is within the range specified for crackers;
- Mini Ciabatte's appearance (size, weight, docking, saltiness and thinness) is like that of a cracker;
- Mini Ciabatte snaps or cracks like a cracker; and
- Mini Ciabatte's long shelf life points to it falling into the biscuit/cracker category.

The case was appealed. The taxable person emphasized in the appeal that the Mini Ciabatte was not a cracker on the basis that the water and yeast content of the mini ciabatte is outside the range of those for crackers.

In Ireland, basic food products are also generally zero-rated. However, certain items are specifically excluded from the zero rate (taxable at standard or reduced rate).

In 2007, Ireland had defined 2,500 subgroups of goods and services in order to implement a three-tier VAT system with standard (21.5 percent), reduced (13.5 percent) and zero rates. Food alone had 89 subgroups such that nuts are zero rated, while roasted nuts are standard rated, cold pizza is zero rated, and warm pizza is reduced rated in a take-away.[378]

Ireland, again, has similar classification issues as the UK. The Irish authorities have some interesting guidance on the classification of bakery products and food supplements.[379]

The supply of bakery products such as cakes, biscuits, bagels and croissants, being flour or egg based bakery products, is liable to VAT at the reduced rate of 13.5%. However, the supply of bread that meets a certain ingredient definition is liable to VAT at the zero rate. The ingredient definition of bread is very specific and although products, such as garlic bread, onion bread and fennel bread are marketed as bread, these products do not generally conform to the ingredient definition of bread and do not therefore qualify for the zero rate of VAT.

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[378] Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union,* 21 June 2007 at p. 12.
[379] Revenue eBrief No. 70/11.

In respect of food supplements, the zero rate applies to the following substances, whether they are marketed as food supplements or not, provided they are formulated to make good the potential shortfall from the nutrition required for a normal, healthy diet:

- Vitamins and minerals in solid form, such as capsules, tablets, pills or lozenges, intended for oral consumption without further preparation;
- Vitamins and minerals in liquid form intended for oral consumption without further preparation, but not including beverages such as high vitamin drinks; and
- Fish oils for oral consumption.

The following substances do not benefit from the zero rate, even if labeled and marketed as food supplements:

- Substances marketed specifically to improve sporting or physical performance, e.g., ergogenic aids;
- Substances marketed specifically for the purpose of bodily sculpture or weight reduction, e.g., slimming aids;
- Substances that, although consisting in whole or in part of ingredients regarded as food supplements, are marketed for use other than for human consumption, such as, liniments, ointments and rubs.
- Substances in the form of bars or sweets or any other form similar to confectionery;
- Beverages of any kind (including water), concentrates, crystals, essences, extracts, powders or other products for the preparation of beverages, unless they come within the scope of certain exceptions.

Specific Country Experience – Education

As with food, GST exemptions for education can give rise to disputes relating to the interpretations of the application of the exemptions resulting in significant administration costs for the government. Some of the issues faced by jurisdictions that have chosen to exempt education are described below.

In Australia, education is zero-rated (GST-Free in Australian terminology), along with associated field trips, course materials and certain boarding accommodation. Education includes:

a) a pre-school course; or
b) a primary course; or
c) a secondary course; or
d) a tertiary course; or
e) a special education course; or
f) an adult and community education course; or
g) an English language course for overseas students; or

h) a first aid or life-saving course; or
i) a professional or trade course; or
j) a tertiary residential college course.

The Australian Tax Office has issued a number of rulings to help taxpayers navigate the complexities around determining whether an education related service falls within the GST relief. Three of the rulings governing primary, secondary, tertiary and special education amount to 73 pages of examples of what is, and what is not, subject to GST.

For example, an amenities fee paid by students a university used for plant and equipment, buildings, lockers, childcare and parking facilities is not subject to GST while payments for using such facilities, such as parking, are subject to GST. However, at another college, students pay a $20 amenities fee but are given a photocopy card to the value of $20. This amenities' fee is subject to GST.

While Australia treats education as not subject to GST, the Australian Bureau of Statistics found that in 2009-10, while the wealthiest 20% of households spent 2.3% of their annual expenditure on primary and secondary school fees, the poorest 20% spent only 0.35%. This suggests that the taxation of education is not as regressive as one might think as wealthier households spend more of their income on education than poorer ones.

The European Union (EU) VAT Directive provides that member states shall exempt the provision of children's or young people's education, school or university education, vocational training or retraining, including the supply of services and of goods closely related thereto. Such goods and services need to be supplied by educational bodies governed by public law. In addition, tuition given privately by teachers and covering school or university education is also VAT exempt.

The provision has given rise to many disputes with regards the scope of the VAT exemption.

In Germany, for example, the tax authority considered that research activities performed by public sector higher education establishments fell into the provision of the VAT exemption for education. The Court of Justice of the European Union (ECJ) however held that only closely related activities to university education may fall under the VAT exemption. As making the research activity subject to VAT would not increase the cost of education, and because research activities performed by universities are not essential to the provision of university education, the ECJ held that research activities performed by universities are subject to VAT.[380]

Another dispute concerned what "school or university education" means. The ECJ held that the phrase is not limited only to education which leads to examinations for the purpose of obtaining qualifications or which provides training for the purpose of carrying out a professional or trade activity, but includes other activities which are taught in schools or universities in order to develop

[380] C-287/00, Commission v. Germany (Jun. 20, 2002).

pupils or students' knowledge and skills, provided that those activities are not purely recreational.[381]

In the UK, a private individual argued that the golf tuition he gave in his capacity as a director of a company must be exempt from VAT because the same tuition was exempt when he provided it as a partner in a partnership. The tribunal held that the VAT exemption is not applicable because the individual was not a body governed by public law or a body with similar objects having education as its aim.[382]

A golf club also argued that "green fees" should fall within the VAT exemption for education services. The issue is currently referred to the ECJ, which has to decide whether the VAT exemption requires that the scope of the exemption for services closely linked to sport education is restricted to membership fees. In such a case, "green fees," which merely constitute additional revenue for the club should not fall within the scope of the VAT exemption.[383]

Specific Country Experience – Healthcare

Healthcare exemptions face similar issues. Primarily in respect of what types of healthcare should be exempt and classification issues relating to whether a particular type of service falls within the exemption.

Defining the categories of exempt healthcare can be problematic. For example, should only services provided by registered health professionals (i.e., doctors and nurses) be exempt or should the exemption be extended to include all services intended to protect/maintain/restore the health of individuals. If the latter, should acupuncture be included but hypnotherapists, yoga and homeopathy be excluded?

In terms of medication, should only prescription drugs be exempt from GST or should certain "over the counter" drugs also be excluded? How should over the counter drugs be treated where they are prescribed by a doctor?

These types of issues create political pressure for exemption creep.

Even once a set of exempt categories has been determined, as with other exemptions, issues can arise in respect of whether a particular good or service falls within an exemption. For example, in Australia, "appropriate" dental treatment is not subject to GST. In order to help with interpreting the term "appropriate treatment", the Australian Tax Office has issued a ruling. An extract from this ruling is reproduced below to illustrate the complexity of such exemptions:[384]

> *"Appropriate treatment" also includes medical treatment of a preventative nature, for example, a periodic oral examination where there is no evidence of an ailment prior to attendance. However, this does not extend to the supply of services and*

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[381] C-473/08, Ingenieurburo Eurlitz (Jan. 28, 2010).
[382] MarcusWebb Golf Professional v. Her Majesty's Revenue and Customs, UK FTT 388.
[383] Bridport and West Dorset Golf club v. Commissioner of Her Majesty's Revenue and Customs, [2012] UKUT 272 (TCC).
[384] CR 2013/14 - Goods and services tax: goods and services supplied by dentists (20 February 2013).

goods in relation to customized mouth guards. Whilst a customized mouth guard is a device that may prevent or reduce damage sustained to the mouth and teeth in the event of an injury, it is not considered to be 'treatment' that is performed on a patient.

43. To be GST-free, the dental profession must accept that the service is necessary and acceptable treatment, taking into account the patient's individual circumstances.

44. Services provided in assessing a patient for insurance or litigation purposes, that is, medico-legal services, are not 'necessary for the appropriate treatment' of the patient and are not GST-free.

45. Services which are predominantly for the improvement of the appearance of the patient are also not 'necessary for the appropriate treatment' of the patient and therefore, are not GST-free.

46. Services that are intended to improve the health of the patient but which also comprise a 'cosmetic' component, for example, reconstruction of a badly damaged tooth, are 'necessary for the appropriate treatment' of the patient and are therefore, GST-free.

The EU VAT Directive provides that Member States should exempt the following services:

- hospital and medical care and closely related activities undertaken by bodies governed by public law or, under social conditions comparable with those applicable to bodies governed by public law, by hospitals, centers for medical treatment or diagnosis and other duly recognized establishments of a similar nature;
- the provision of medical care in the exercise of the medical and paramedical professions as defined by the Member State concerned;
- the provision of medical care in the exercise of the medical and paramedical professions as defined by the Member State concerned;
- the supply of human organs, blood and milk.

These provisions have been implemented in the 28 member states in various ways and resulted in abundant case law from both national courts as well as the ECJ.

The ECJ held that the VAT exemption applies to medical services consisting of:

- conducting medical examinations of individuals for employers or insurance companies,
- the taking of blood or other bodily samples to test for the presence of viruses, infections or other diseases on behalf of employers or insurers, or
- certification of medical fitness, for example, as to fitness to travel.

However, the VAT exemption does not apply to the following services:

- giving certificates as to a person's medical condition for purposes such as entitlement to a war pension,
- medical examinations conducted with a view to the preparation of an expert medical report regarding issues of liability and the quantification of damages for individuals contemplating personal injury litigation,
- the preparation of medical reports following examinations referred to in the previous indent and medical reports based on medical notes without conducting a medical examination,
- medical examinations conducted with a view to the preparation of expert medical reports regarding professional medical negligence for individuals contemplating litigation,
- The preparation of medical reports following examinations referred to in the previous incident and medical reports based on medical notes without conducting a medical examination.

In determining which services were subject to the VAT exemption and which should be taxable, the ECJ observed that only medical services effected for a purpose of protecting, including maintaining or restoring, human health should benefit from the exemption. The fact that other services whose aim is not to protect human health should be taxable does not increase the cost of healthcare.[385]

The ECJ also held that supplies of dental prostheses made by an intermediary who does not have the status of dentist or dental technician are not covered by the exemption.[386] However, the same supply would be exempt if performed by a dentist or dental technician.

A Danish taxpayer argued that the VAT exemption applies to the collection, transportation, analysis and storage of umbilical cord blood for possible future therapeutic use, when those services are supplied by a private stem cell bank which is officially authorized to handle stem cells from such blood. As stem cells are collected only to ensure that a particular resource will be available for medical treatment in the uncertain event that treatment becomes necessary but not, as such, to diagnose, treat or cure diseases or health disorders, the ECJ held that activities consisting in the dispatch of a kit for collecting blood from the umbilical cord of newborn children and in the testing and processing of that blood and, where appropriate, in the storage of stem cells are not VAT exempt.[387]

However, the ECJ held also that the removal of joint cartilage cells from biopsy cartilage material taken from a human being and their subsequent multiplication, with a view to reimplantation for

[385] C-307/01, D'Ambrumenil (Nov. 20, 2003).
[386] C-401/05, VDP Dental Laboratory (Dec. 14, 2006).
[387] C-86/09, Future Health Technologies (Jun 10, 2010).

therapeutic purposes, constitute the "provision of medical care," regardless of whether the cells obtained from the cell multiplication are intended for reimplantation in the donor or in another person.[388]

An Austrian court held that the services of practitioners of "mental suggestion" do not qualify for the exemption for medical care because practitioners of "mental suggestion" treat patients during individual therapeutic sessions by means of hypnosis and mental suggestion, and are not designated as paramedical professionals.[389]

According to a Swedish court, medical advice given by a certified nurse by telephone is not covered by the exemption for medical care because the nurse's advice is not based on physical examination of the patient and the nurse does not actually treat the patient.[390]

The Swedish tax authority considered that cosmetic and plastic surgery constituted medical care that is exempt from VAT and thus denied a taxpayer the input VAT recovery right on purchases made for this activity. The ECJ held that cosmetic and plastic surgery should be VAT exempt if those services are intended to diagnose, treat or cure diseases or health disorders or to protect, maintain or restore human health. The subjective understanding of the person who undergoes plastic surgery or a cosmetic treatment has of it is not in itself decisive in order to determine whether that intervention has a therapeutic purpose. It is also not sufficient that the surgery is performed by a qualified medical practitioner.[391]

A Dutch court observed that independent anesthesia assistants, who assist anesthesiologists during surgery in hospitals and clinics provide services that an essential part of the medical treatment of the patient. Therefore, the services provided by the independent anesthesia assistants should be VAT exempt.[392]

The UK tax authority considered that prescription glasses ordered through an online ordering procedure are subject to VAT as they constitute a distinct supply to the eye exam provided by a different optician or optometrist. The UK tribunal held that the supplies in question should be exempt because neutrality requires online suppliers be treated the same as brick and mortar suppliers of the same product.[393]

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[388]C-156/09, Verigen Transplantation Service International (Nov. 18, 2010).
[389]AT: Administrative Court (Verwaltungsgerichtshof), 29 July 2010, Case 2008/15/0291, Other Domestic Case Law IBFD.
[390]SE: Supreme Administrative Court (Högsta förvaltningsdomstolen), 9 Feb. 2011, Case 5772-10, Other Domestic Case Law IBFD.
[391]C-91/12, PFC Clinic (Mar. 21, 2013).
[392]NL: Court of Appeal (Gerechtshof) of Hertogenbosch, 4 Oct. 2013, Case 13/00538, Other Domestic Case Law IBFD.
[393]Prescription Eyewear v. HM Revenue and Customs, TC02759, [2013] UKFTT 357 (TC).