The voice of banking & financial services

BBA response to the Organisation for Economic Co-operation and Development (OECD) International VAT/GST Guidelines

The British Bankers' Association (BBA) is the leading association for the United Kingdom banking and financial services sector, representing over 200 banks, which are headquartered in 50 countries and have operations in 180 countries worldwide.

We would, of course, be happy to clarify any points raised in these comments, or to discuss further any issues relating to our understanding of the OECD's intentions.

General Comments

The BBA welcomes the opportunity to comment on the international VAT/GST guidelines and commend the OECD for the work they have undertaken to date. We strongly support the development of these guidelines which we believe will encourage consistency across jurisdictions, provide business with increased certainty and reduce risk to both governments and business. The application and monitoring of VAT compliance represents a significant and disproportionate cost for the financial services sector. It is broadly accepted that the practical implementation of VAT exemptions and ability to reclaim input VAT varies between countries, it is therefore worth noting that in the context of neutrality, the guidelines must aim to achieve a level playing field. Additional clarity and certainty will help reduce both the administrative burden as well as complexity to the benefit of both tax authorities and business.

Whilst we have provided comments on specific aspects of the guidelines below, the BBA would make the following general observations on the current draft.

VAT as a consumption tax

We note that here are several references within the guidelines to VAT being a tax on consumption and that the preface, Chapter 1, paragraph 1.2 expands this reference to include not only private individuals but also entities engaged in non-business activities. We consider it important to recognise that VAT is not always a tax on final consumption for all businesses, particularly in the financial services and other sectors such as health and education.

Reference to 'final-users' often results in significant complexity for the Financial Services (FS) sector where this is taken to only include private individuals. For businesses engaging in exempt activities, VAT is a cost both in absolute (cash) terms and in terms of the resources required to administer the tax. Recognition within the guidance that entities engaged in exempt activity also constitute 'final-users' is vital to ensuring that the guidelines are practical and workable for those businesses. It would also usefully correct the misperception that exemption equates to non-payment of VAT.

Scope of the main rule as applicable to Multi Location Entities (MLEs)

The BBA supports the principles behind the clarification of jurisdictional taxing rights when supplies are made to MLEs but feel that further clarity is required. We understand, from discussions with OECD and UK government representatives on WP9, that it is the intention to tax only those bought in services which are passed unaltered onto other MLE establishments without any modification or use in the location of the establishment of recharge. The BBA agree that this would be entirely in line with the fundamental principle that services and intangibles should be taxed in the country of consumption. The recharge model proposed represents a practical mechanism for identifying the location of consumption and therefore the jurisdiction which has the taxing rights. However, the BBA feel that a distinction needs to be drawn between those instances where external costs are incurred and consumed as part of a separate supply further. For example global software licenses which are used locally but purchased centrally, versus global software licences which are purchased and used in the establishment with the business agreement as part of a wider IT service. In the latter case we consider that the initial supply is consumed by the IT hub and, even though the cost of the license may be a cost component of the onward supply, there is no consumption of the original license in any other MLE jurisdiction. This is entirely consistent with the principal of tax on consumption.

The intention that the guidelines only deal with unaltered services is implicit in a number of places within the guidelines. However, to aid clarity, the BBA feel that this matter should be made more explicit within the guidelines and we have commented on these specific areas in the main body of our response below.

Consistency

There are some aspects of the guidelines where multiple options are suggested as a potential approach for OECD members to follow. The BBA would caution against this provision which may lead to the development of an inconsistent approach to the application of these guidelines. FIs and other business desire certainty in their dealings and providing for multiple treatments, risking double taxation and thus undermining the purpose of the guidelines.

Anti-avoidance

We note that the guidelines have been developed with a presumption that they are being applied to legitimate transactions and that anti-avoidance provisions are outside the scope of these guidelines. However we would caution that these guidelines will need to be reconsidered in light of the anti-avoidance proposals. BBA members are supportive of further guidelines around anti-avoidance and look forward to working with the OECD on this matter in due course.

Double taxation and double non-taxation

We welcome provisions within the guidelines to guard against double taxation and double non-taxation. However there are areas where further clarity could be provided within the guidelines. Neutrality is of course a core principle behind the OECD guidelines project, we have highlighted below where there is a potential for neutrality to be compromised simply

because the cross border VAT model on input tax is not uniform across the member countries. We have commented on these specific areas below.

Reciprocity

Applying a VAT refund mechanism on the basis of reciprocal arrangements could undermine the principle of neutrality and is not supported by business. It is our view that reciprocity should not play a part in a neutral VAT/GST system.

Application

The BBA would caution that that these guidelines lose value if regional bodies such as the EU were not to adopt them as this would create a conflict in the application of these guidelines by OECD members who are also members of the EU.

Specific comments on the guidelines

Preface

Paragraph 5

The detailed guidelines, including but not limited to those related to supplies to MLEs, do not consider how the subtraction method would apply. If the reference to the subtraction method is to be included it may be appropriate to develop detailed guidelines in this regard.

Paragraph 7

The successful functioning of the VAT system is intrinsically linked to the full co-operation of business and the partnership between business and government to make the system work effectively. It is our view that there should be stronger reference made to positive partnerships between business and government, the need for VAT systems to be simplified to aid both parties and reduce the compliance cost to the collecting agents.

CHAPTER 1: Core Features of Value Added Taxes Covered by the Guidelines

1.2

We note that there are several references within the guidelines to VAT being a tax on consumption and that the preface, Chapter 1, paragraph 1.2 expands this reference to include not only private individuals but also entities engaged in non-business activities. We consider it important to recognise that VAT is not always a tax on final consumption for all businesses, particularly in the financial services and other sectors such as education.

Reference to ‘final-users’ often results in significant complexity for the FS sector where this is taken to only include private individuals. For businesses engaging in exempt activities, VAT is a cost both in absolute (cash) terms and in terms of the resources required to administer the tax.

We therefore propose that reference be made to the fact that the cost of VAT is borne not only by final consumers but also by those businesses involved in VAT exempt sectors.

1.5

We would reiterate our comments above on paragraph 5 of the preface.

1.6

The BBA would respectfully suggest the addition of the following to the end of paragraph 1.6 to help explain the exemption model:

"An exception exists for businesses making exempt supplies, where no input tax may be recovered. In these situations, the exempt business is treated similarly to a final consumer, and does bear the burden of VAT incurred."

1.10

We endorse the comment that the destination principle is preferable to the origin principle.

1.15

Although we endorse the generally accept tax policy principles set out, we would caution the use of 'flexibility' and its impact upon the principles of 'certainty and simplicity'. The BBA does not believe there is need to apply the principle of 'flexibility' beyond the narrow scope of the current wording, which deals with changing business practices/technology changes, other than in exceptional circumstances such as anti-abuse.

CHAPTER 2: Neutrality of Value Added Taxes in the Context of Cross-Border Trade

We note that the consultation has not asked for specific comment on Chapter 2 of the guidelines. However, we have highlighted points below that are specifically linked to the sections of the guidelines we have been invited to comment upon so that consistency of the overall document can be considered.

Guideline 2.6

2.24

We welcome this provision which should support the principle of neutrality and reduce the compliance burden on tax authorities and business when dealing with VAT systems.

2.4.2 Reciprocity

We would reiterate the comments made above about reciprocity and highlight how inconsistencies in applying this internationally could negatively affect the principle of neutrality.

***2*.4.3 Groups of countries**

As above at our general comments on consistency and application, we would not wish to see inconsistencies develop in the interpretation and application of these guidelines by group of countries.

2.4.5

The BBA welcomes this commentary which should provide additional clarity about determining whether businesses are in 'similar situations'.

2.48 and 2.49

We would expect the concept of "similar transactions" to be relevant to the application of the rules in Chapter 3 on supplies to MLEs. We note that the wording of section 2.48 states that this should be considered by reference to "the characterisation of the particular services or intangibles supplied." We would agree with this statement and it is relevant to our points regarding straight pass-through of costs. However, we would consider that the sentence that follows this "the terms under which the services or intangibles were acquired should not be relevant to this determination [i.e. of the characterisation of the particular services]" could create confusion: the terms under which services are provided are often a key part of the substance of determining what that service is and would surely be relevant to how it should be characterized under the relevant applicable law.

2.57

The BBA would request clarification on the significance of Germany's disagreement and how this might affect the efficient operation of the guidelines.

CHAPTER 3: Determining the place of taxation for Cross-Border Supplies of Services and Intangibles

3.2

We support these principles and believe that adhering to them will significantly reduce the costs for Government and business.

3.18

The BBA believes that the reference to 'future' creates significant uncertainty and provides for the attachment of taxing rights to something considered to be relevant to events which have not actually happened. This introduces an unhelpful element of subjectivity. To ensure consistency and certainty, we would respectfully request that this be either removed or qualified by references to the normal tax point rules in the jurisdiction of taxation. This reference should not be in relation to the time of taxation. The BBA would respectfully suggest this could be covered under section 3.80.

Guideline 3.5

The BBA would respectfully suggest that the use of the term 'unaltered' should be inserted into this guideline to clarify that ultimate taxing rights beyond the jurisdiction where the customer establishment that enters into the business agreement is located is only relevant where an MLE establishment other than that which enters the business agreement uses the service/intangible in an unaltered manner (i.e. for straight pass through costs). The BBA understand that this is in line with the intentions of the OECD and WP9 but feel that further clarity of this is required in the guidelines. The first sentence would then read: "In those cases where the services are used ***unaltered*** by one or more establishments".

Footnote 29

"Use of a service or intangible" differs from the concept of "*use and enjoyment*" existing in national laws, which can refer to actual use by a customer in a jurisdiction irrespectively of the presence of any customer establishment.

The BBA believes that this is an important aspect of the guidelines and we would ask the OECD to clarify why this was listed as a footnote rather than included in the main body of guidelines. We would recommend that this concept be brought into the main body of the guidelines.

3.19

Rather than 'will be charged' we would propose 'pay for their share of the service'. This would be consistent with the concept of pass through costs where the location with the business agreement is not consuming the service or intangible.

3.21

It is our understanding that the guidelines have been prepared on the basis that all transactions in scope would be legitimate transactions. If this is the case we believe that this section of the guidelines overreaches itself and that these provisions (which we presume are related to concerns over illegitimate activity) are inappropriate. Any concerns regarding illegitimate activity should be addressed in the anti-abuse guidelines.

3.22

The BBA agrees that there is no recharge where the business is using the supply wholly.

3.23

We agree with the scope of the guidelines set out in this section and that this should not apply to internally generated services. However, it is unclear how this would apply to external costs and it may be necessary to expand this section (see comments below relating to paragraphs 3.26-3.27).

3.26-27

We would welcome confirmation that these paragraphs (and moreover Guideline 3.5 generally) only apply to services (or distinct parts of the service) that are not consumed by establishment of recharge.

For example, where a hub purchases services from third parties and uses these different elements to provide an internal support service (e.g., an IT support service which may be priced to include cost components of the bought-in services), we would consider the external services to be consumed by the establishment of recharge and not require taxation at an MLE level when the service charges are made.

Currently, it is not immediately evident from the guidelines what VAT treatment would be applied in such circumstances and we feel that the concept requires clarification at a more practical level in order to ensure that it is interpreted in a uniform and not overly broad

manner. We would be pleased to support with more fully developed business examples, if this would be helpful.

The BBA is concerned that the current wording in these paragraphs could be construed to require that services between MLEs (where the pricing is determined economically by reference to costs – whether internal or external) would need to artificially split and an element of the charge subjected to VAT simply by virtue of a reference to an external cost component of the pricing. We feel that this would be contrary to the principle of tax on consumption as, the external cost are consumed by the establishment of recharge and should not be subject to tax in any other jurisdiction.

3.27

As previously noted, the process of identifying externally acquired services that are passed on unaltered can represent an extremely difficult task and potentially places a disproportionate burden on financial service business given the complexity of modern supply chains (internal cost allocation may be achieved in various ways within a MLE including by reference to a combined "product" rate card, calculating a total cost of a product, it may be separated by business or product line, or covered by over-riding inter-company agreements) and the fact that IT systems are not sufficiently developed at present to automate such a process (the process of tracking externally acquired costs through an internal supply chain would require manual intervention and, most likely, the use of spreadsheets to record the results).

Therefore, the need to provide an audit trail at a transactional level may result in an overcomplicated and onerous process which is unmanageable both for businesses to prepare and for tax authorities to review. Paragraph 3.70 refers to the use of "fair and reasonable" allocation keys for MLE cost apportionment purposes. We would respectfully suggest that further consideration should be given to whether the means employed to actually identify costs which require allocation should also be fair and reasonable including the use of appropriate proxies where necessary.

3.55

We are concerned that wording in this section on input tax deduction may be incorrect and not in accordance with our understanding that any input tax incurred on costs which are used in another country should be recoverable in full, where that cost is recharged to another MLE country, and taxed under "step 2" of the MLE rules. This is essential in preserving neutrality and ensuring that there is no double taxation. However, there are some countries that will apply a fixed recovery percentage to cost where direct attribution to a taxable supply cannot take place (because there is a single invoice from the supplier). In these instances there would be effectively double taxation and the BBA would request that the guidelines clarify this point.

Where there isn't a right to deduction the reverse charge at the end of the transaction should be provided for. In any event, the guidelines should set out possible remediation processes where double taxation or double non-taxation occurs as a result of existing national legislation. We would urge the OECD to progress this matter where possible.

3.60 and 3.62

The BBA endorses the commentary contained in these sections of the guidelines

3.68-3.69

We welcome this aspect of the guidelines but question how far guidance can be provided on the general proxies which can be used.

3.70

The BBA believes that this paragraph could introduce subjectivity and that 'fair and reasonable' and 'size of business' could be complicating factors when set against the need for these guidelines to be applied consistently.

3.72

The BBA believes that where a cost is recharged as a pass-through it would be reasonable to expect that ring-fencing could be practically achieved. However, the wording in this section cautions against the initial supply to the MLE (first step) and the onward recharge (step two) becoming obscured. Please note our comments with regard to 3.26-27 above – it is fundamentally important to recognise that such a recharge within an MLE network does not represent a supply and therefore when a third party service becomes a cost component of a subsequent, broader product, this should not be seen as an obscuring of step one but a clear case that the subsequent charge and its separate pricing indicates that there has been use at step one and the recharge as a cost component is not a pass-through.

3.74

We would request further clarity around the right to deduct VAT as outlined above in our comments in relation to paragraph 3.55.

3.79

Consistent with our above comments in relation to Guideline 3.5 and paragraphs 3.23, 2.26-3.27 we feel that this paragraph is confusing and can be interpreted as requiring that services are artificially split into its cost components. Amending the paragraph along the following lines would arguably provide clarity:

"Where the recharge of a service or intangible purchased from an external supplier *but used by another MLE establishment* is bundled with a *separate supply to form a single charge (for example, to simplify the accounting and settlement)*~~*wholly internal cost charge (e.g. salary expense of wholly internally supplied services)*~~, it is for the MLE to separate the cost of the externally purchased service or intangible from the other costs and to evidence the internal character of these costs if this is necessary to ensure that the recharge method is only applied on the ~~*cost of the*~~ externally purchased service or intangible *used by such establishment*".

Annexes

The BBA welcomes the inclusion of the additional information contained within the Annexes but believe these could be made more user-friendly. Some of the examples were also seen

to be too business subjective (e.g. by reference to how a business may implement ERP systems) and therefore perhaps not the best way to demonstrate how these principles should be applied.

The BBA would suggest that the annex includes explicit reference that Example 2 in Annex 1 is equally applicable to MLEs. This could be expanded to include a specific MLE example or included as part of Annex 2.

The BBA notes that the final paragraph on page 54 may create confusion between the provision of services and the performance of activities in the course of providing those services.

In particular it would be helpful to clarify the sentence that reads “The fact that services are *supplied to* someone...different from those to which the services are directly provided is not relevant in this example”.

It would be preferable to make clearer the distinction between ‘supplied to’ (determining the relationships for VAT) and ‘provided to’ (being more about the underlying performance).

Concluding remarks

The BBA believes that dialogue between business and tax authorities has been of significant benefit to all parties in the drafting of these guidelines to date. Where there are still areas of concern, the BBA would welcome the opportunity to provide further assistance with the drafting of amendments, or further information where required.

British Bankers’ Association
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