Deloitte.

Committee on Fiscal Affairs, OECD

Invitation for comments on OECD international VAT/GST Guidelines

Deloitte contribution

May 2013

Deloitte.

Piet Battiau
Consumption Taxes Unit
Centre for Tax Policy and Administration
OECD

London, 3 May 2013

Comments on the new draft elements of the OECD International VAT/GST Guidelines

Dear Piet,

Further to your invitation for comments, we are pleased to respond on behalf of the global member firms of Deloitte Touche Tohmatsu Limited ("Deloitte") to the OECD's Committee on Fiscal Affairs consultation on the new draft elements of the OECD International VAT/GST Guidelines (the Guidelines), published in February 2013.

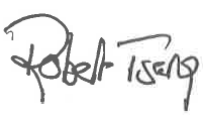
Deloitte has extensive international experience in advising the governments of OECD member countries and more widely in relation to developing their VAT/GST systems. We have also many international clients, who are active in sectors most impacted by the Guidelines (e.g. telecoms). Additionally, Deloitte is contributing to the work on the Guidelines through our participation in WP9. Therefore we are very familiar with the Guidelines and have regularly referred to its principles in our analysis and recommendations.

We support the OECD's work on the Guidelines and their aim to address uncertainty and the risks of double taxation and unintended non-taxation that result from inconsistencies in the application of VAT/GST to international trade. In preparing our global response to the consultation, we arranged four conference calls with our largest clients in all regions (over 300 attendees in total) in order to introduce the OECD VAT/GST Guidelines and obtain their input. We have summarised below the points made by our clients and our own thinking on the new draft elements of the Guidelines.

We hope that you will find our contribution useful and are looking forward to further opportunities to work with you. We are happy to discuss any comments or questions you may have regarding these responses. Please do not hesitate to contact David (+44 113 292 1707/draistrick@deloitte.co.uk), Justin (+44 20 7303 0469/juwhitehouse@deloitte.co.uk), Odile (+33 1 40 88 29 98/ ocourjon@taj.fr) or Robert (+65 6530 5523/ robtsang@deloitte.com).

Yours sincerely,



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1. Background

1.1 Consultation on new draft elements of the OECD International VAT/GST Guidelines

The OECD published in February 2013 a draft consolidated version of International VAT/GST [1] Guidelines, containing the previously consulted guidelines and commentaries and some new draft elements of the Guidelines. We understand this is not yet the full set of guidelines and some further elements (e.g. B2C guidelines) are still to be developed, with the objective of arriving at a complete set of guidelines applying to cross-border trade in services and intangibles by the end of 2014.

The drafts on which public comments were invited are:

- A draft Preface of the Guidelines;
- A draft Chapter 1 of the Guidelines, on the core features of VAT systems to which the Guidelines are intended to apply;
- Draft Guidelines on place of taxation for cross-border supplies of services and intangibles to businesses that have establishments in more than one jurisdiction;
- Draft Guidelines on the implementation of specific rules for determining the place of taxation for cross border business to business supplies of services and intangibles.

1.2 Deloitte contribution

There is no doubt that the OECD work on the international VAT Guidelines is significant in shaping VAT systems throughout the world, especially outside the European Union (EU), e.g. in Asia, Middle East and Africa. By developing the Guidelines based on the core principles of VAT, the neutrality principle and the destination principle, the OECD addresses the key problems businesses face when dealing with international trade in services – uncertainty and double taxation resulting from the inconsistent application of VAT.

Deloitte recognises the importance of the OECD work on a global level and has been focussed in preparing our response to the consultation on the Guidelines. We arranged four conference calls with our largest clients in all our regions (Asia Pacific; Europe, Middle East and Africa; Americas) in order to introduce the Guidelines and obtain clients' input on the impact they might have on their business and more generally on the international role of the Guidelines. The calls were popular and well attended - we had over 300 attendees in total and especially high interest from the Asia Pacific region.

In the following parts of response, we have summarised the points made by our clients and our own thinking on the new draft elements of the Guidelines.

[1] In our response, we use the term 'VAT' to mean both VAT and GST, as appropriate.

2. Preface and Chapter 1 – Context and Core Features

2.1 Background

Public comments are invited on:
- the draft Preface of the Guidelines, setting out the context of the Guidelines, their purpose and scope and their development process; and
- the draft Chapter 1 of the Guidelines, setting out the core features of VAT systems to which the Guidelines are intended to apply.

2.2 Preface

The Preface presents the context of the Guidelines, their purpose and scope and their development process.

Our comments:
- We consider that the draft Preface fills its purpose well and provides an appropriate context to the Guidelines;
- The Preface describes the staged process used for developing the Guidelines. We had understood that the current draft is not intended to cover the financial services sector - however further work is planned to deal with the specific problems of this sector. We find this information very relevant and important, but it is not currently mentioned in the Preface. As the Guidelines in Chapter 3 (especially Guideline 3.5 on recharging internal supplies) could potentially have a significant impact on the sector, it might be advisable to state clearly the intentions of the Committee on Fiscal Affairs regarding Guidelines on financial services or for the financial sector;
- Our clients were generally satisfied with the wording of the draft Preface. They recognise and appreciate the opportunity for business to be involved in the process of developing the Guidelines and are pleased that the Guidelines address a number of their concerns;
- Some noted, however, that the Guidelines should go further and take into account the way in which transfer pricing, corporate income tax and VAT apply to transactions and events.

2.3 Chapter 1 on core features of VAT covered by the Guidelines

The draft first chapter is in substance a synthesis of the principles of VAT as generally accepted in OECD member countries and beyond. The function of this chapter is to identify those taxes to which the Guidelines apply and to set the scene for the Guidelines proper - to describe the principles on which the Guidelines are based.

Our comments:
- Businesses support the OECD's promotion of the main principles of VAT policy and noted that these should be more uniformly adopted by tax authorities in order to avoid conflicting and confusing rules creating difficulties in the application and interpretation of VAT law.

<u>On the destination principle</u>
- Businesses recognised and concurred with the importance of the destination principle in achieving neutrality in international trade on the one hand, and certainty and simplicity in the application of the VAT rules on the other. A common application of this principle would lead to a

more efficient global VAT system, avoiding unnecessary administrative burdens on taxpayers and facilitating the work of the tax authorities.

- Non-application of the destination principle often gives rise to additional costs for businesses, which is contrary to the neutrality principle. An example was given of some transactions related to telecommunication services between a US entity and an EU company (e.g. roaming services), where VAT is being charged and remains irrecoverable because there are no reciprocity agreements or because the administrative costs of getting a refund are too high relative to the amount of the refund at stake.

<u>On implementation of the destination principle by use of the reverse charge</u>

- Clients strongly support the use of the reverse charge mechanism in the implementation of the destination principle in order to avoid unnecessary VAT registrations, which create extra administrative burden on the taxpayers' side. The point was made that from a tax authority's perspective, it should be irrelevant who pays the VAT due; it ought to be even easier to deal with a domestic business.
- Businesses also strongly support the Guidelines' approach that where the reverse charge would prima facie apply to an entity with full VAT recovery, the entity should not be required to report the relevant transactions, thereby avoiding unnecessary administrative costs, as there is no VAT to be paid to the tax authorities.

<u>On the application of generally accepted principles of tax policy to VAT– neutrality & simplicity</u>

Although Chapter 2 is not included in the consultation at this stage, clients made several points relating to the neutrality principles and the Guidelines 2.1 – 2.6. We are including these in our submission to inform your further work on the Guidelines more generally.

- Some mentioned discrimination between the public and private sectors, and noted that it might not be always fair to use the right of deduction as a basis for assessing the similar situations that ought to be subject to similar levels of taxation. It was suggested that public bodies should be recognised as taxable persons if similar services can be provided by privately-owned companies.
- Some businesses also felt that the EU VAT rules might not fully meet the criteria for non-discrimination of foreign businesses on the level of tax and on specific administrative requirements.
- Guideline 2.5 - Suggestion was made that the Guidelines could be made stronger by allowing cross border VAT refunds as a method to ensure that foreign businesses would not incur irrecoverable VAT.
- Guideline 2.3 – We have a specific drafting suggestion, 'VAT rules should be framed in such a way that they are not a **significant** (*instead of 'primary'*) influence on business decisions'. Clearly significant requires a level of subjectivity whereas "primary" connotes majority on an objective basis.
- Regarding the simplicity principle, unsurprisingly, general comments were made that multiple rates complicate the system. Any rate other than a standard VAT rate should be avoided in our view where possible. This would help in achieving neutrality and avoid complexity in determining scope, especially with respect to mixed supplies (bundles). Also, additional rules, such as, e.g. "use & enjoyment" should be avoided if possible, given that these only add complexity.
- Businesses raised a question regarding the proportionality of the domestic reverse charges used in many EU Member States. Such rules further complicate the VAT systems and would not comply therefore with the principle of simplicity.
- Clients also mentioned that aligning the taxation principles of goods and services would help to simplify tax systems.

3. Chapter 3 – Determining the Place of Taxation for Cross-border Supplies of Services and Intangibles

3.1. Background

In Chapter 3, public comments were invited on:

- the draft Guidelines on place of taxation for cross-border supplies of services and intangibles to businesses that have establishments in more than one jurisdiction, covering Guidelines 3.4 and 3.5 with commentaries; and
- the draft Guidelines on the implementation of specific rules for determining the place of taxation for cross border business to business supplies of services and intangibles, covering Guideline 3.6 with commentaries.

3.2. Guidelines 3.4. and 3.5 on multiple location entities

Guideline 3.4
When the customer has establishments in more than one jurisdiction, the taxing rights accrue to the jurisdiction(s) where the establishment(s) using the service or intangible is (are) located.

Guideline 3.5
In those cases where the services are used by one or more establishments other than the establishment that entered into the business agreement, the taxing rights are allocated in two steps. In the first step, taxing rights are allocated to the jurisdiction where the customer establishment that enters into the business agreement is located. In the second step, taxing rights are allocated to the jurisdiction where the customer establishment that uses the service or intangible under a recharge arrangement is located.

Box 3.2 Recharge arrangement
The recharge arrangement is the arrangement that undertakes the role of the business agreement for internal recharges that are treated as supplies within the scope of VAT under the recharge method. The recharge arrangement consists of elements that identify the parts of the MLE that make and receive an internal supply that is within the scope of VAT and the internal rights and obligations with respect to this supply.

Our comments:

Guideline 3.4

- Based on the received feedback, most businesses consider that the approach in the Guidelines for multiple location entities was reasonable, mirroring the existing practice in various jurisdictions, which should make it easier to promote the Guidelines more widely. Dealing with these issues is particularly timely – businesses struggle with variations in practice, especially in the countries in the Asia Pacific region.
- The main comment on this Guideline was that in order to determine whether a business has establishments in several jurisdictions, further clarification of the term “establishment” may be needed. For example it would be helpful to make specific mention of the way that people, resources, intellectual property and physical location should rank - these are after all typical requirements for substance. Making a link to transfer pricing requirements and corporate income tax principles may also be useful.

Guideline 3.5 and box 3.2

- The method preferred by most of the clients we canvassed is the recharge method, as this was considered most appropriate to the majority of business structures used, less difficult to implement, less costly to apply and easier to justify to tax administrations. Any other method would be administratively much more burdensome in our view, especially the 'direct use' method.
- However, businesses were concerned about the use of 'deemed recharges'. It was generally considered that only effective recharges should be used, as applying the rule also to deemed recharges might cause additional double taxation, rather than reducing it. For example there might be justifiable reasons for a business deciding not to recharge some supplies which have been used by several establishments.
- There is also a need for additional clarity on recharge allocation. For example, specific rules may be required to ensure that supplies to the head-office which are subsequently allocated to the branches would not fall outside the scope of VAT (e.g. following the *FCE Bank* European Court of Justice case). The rules need to be clear and sufficiently robust to effectively shift the revenue rights to the jurisdiction of the use of the services and for the VAT incurred to be recovered according to the VAT recovery capacity of the entity that benefits from the service (in this case the branch), instead of a VAT recovery made on the basis of the head-office VAT recovery capacity (where the head-office was just the intermediary of the service and may not benefit from it).
- The Guidelines should also go further to cover adjustments to cross-border (service import/export) pricing that businesses make, particularly for transfer pricing purposes. The simplest approach commercially and from a tax perspective would be to have a Guideline that specifies that the price at the time of import or export for VAT purposes should be the primary taxing event, and that any subsequent upward or downward adjustments from a transfer pricing or income tax perspective between related parties should not normally require adjustment from a VAT perspective. Exceptional cases could be identified of course and this rule would not apply to non-related party retrospective adjustments on imports nor exports.
- The main comments from our EMEA clients were made in relation to the mismatch between the Guideline and current EU law. How will these mismatches be addressed and resolved, especially where a company is established in both EU and non-EU countries?
- Questions were also asked about the impact on different sectors if the EU were to amend its rules in accordance with the Guidelines, especially if the rules were changed for all businesses (including the finance sector). Currently as you are aware the application in the various countries of the EU follows mainly the *FCE Bank* ruling.

3.3. Guideline 3.6 on special rules

Guideline 3.6
The taxing rights over internationally traded services or intangibles supplied between businesses may be allocated by reference to a proxy other than customer location as laid down in Guideline 3.2, when both the following conditions are met:

a. The allocation of taxing rights by reference to customer location does not lead to an appropriate result when considered under the following criteria:

- *Neutrality*
- *Efficiency of compliance and administration*
- *Certainty and simplicity*
- *Effectiveness*
- *Fairness.*

b. A proxy other than customer location would lead to a significantly better result when considered under the same criteria.

Our comments:

- As a general comment, many clients said that derogations to main rules create complexity. However most agreed that in some cases they cannot be avoided, e.g international transport, admission to events or services related to immovable property. Still, it was noted that, for example, in the case of composite supplies (bundles), this might result with a very complex mix of different taxation rules.
- With regard to special rules, although the Guidelines are only suggestive, we consider that the definition of services related to immovable property could be clearer - the current broad definition creates too high a risk of a mismatch due to different interpretations by countries that both apply the Guideline in principle, but define the scope very differently.
- Some specific services need more attention – an example is employee relocation services, which include finding accommodation. For example, Belgium and France tax such services differently – Belgium considers these services to be part of a package of services taxed in the country of the supplier according to the main rule. France, however, considers that such services arelinked to the immovable property, taxed in the country where the property is located. The result is double or non-taxation.
- However, some businesses noted that for services other than restaurant services, specific events or immovable property transactions, the special rules may not have much advantage vis-à-vis the main rule, as it would be difficult to evidence that the requirements for the special rules are met and the rules may not be consistent with the business's structures and processes, such as recharge agreements used for transfer pricing purposes or allocation keys used by the head-office according to its global view of the business activity.
- It was also considered that there are too many allocation options offered in this Guideline which leaves too much choice, creating uncertainty and allowing "shopping" for the most favourable one. The suggestion was made to limit the number of allocation options.