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Finance for Europe

Sent by email to: piet.battiau@oecd.org

Friday, 3rd May 2013

Mr Piet Battiau
Head of Consumption Taxes Unit
Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris Cedex 16, France

Dear Mr Battiau,

OECD INTERNATIONAL VAT/GST GUIDELINES

The Association for Financial Markets in Europe (AFME) represents a broad range of European and global participants in the wholesale financial markets. AFME welcomes the opportunity to provide comments on the OECD International VAT/GST Guidelines, more specifically the Guidelines on place of taxation for cross-border supplies of services and intangibles to businesses that have establishments in more than one jurisdiction as set out in paragraphs 3.17 to 3.30 and in paragraphs 3.51 to 3.86.

Preface

We would like to preface our detailed comments on the draft Guidelines with a more general overarching point. VAT/GST is a tax on supplies, and under both civil and common law regimes there can be no provision of services between establishments of the same legal entity, on the grounds that it is impossible for a person to provide a service to itself. Accordingly, we believe that there can be no VAT/GST in such cases.

We believe it is essential that the Guidelines are based on a correct interpretation of the law, so that Member States will be able to implement them with legal certainty.

Overview

It is AFME's view that guidance in this already complex area will be helpful to businesses which have establishments in more than one jurisdiction ("MLE"). However we consider that the current draft raises a number of issues for MLE's in the exempt sectors. Such MLE's already suffer a considerable compliance and administrative burden, because of the complexity of their VAT/GST arrangements. Accordingly we believe the draft guidance needs to be supplemented to provide further clarification. More generally, we believe that in order to ensure that the proposals can be

successfully implemented, it is essential that they contain the following elements:

(a) Consistency – there should be a common implementation of rules applied across all participant countries;
(b) Those services within scope of the Guidelines (pass through costs) should be better defined, and examples given of what is, and what is not, consumption of a service;
(c) Allowance is made for alternative valuation methodologies for pass through costs in certain circumstances;
(d) Input tax deduction – this should be fully allowed in respect of any amounts which are subsequently recharged as pass through costs;
(e) Existing legislation designed to tax consumption of services by MLEs in a different location to where they have been supplied (for example 'use and enjoyment') should be repealed; and
(f) The tax point for transactions between establishments of an MLE should be identifiable in the records of the MLE.

Detailed comments

Consistency

From a business perspective one of the most difficult issues to deal with is the difference in interpretation between countries, both within and outside the EU. MLEs frequently find that the same transaction must be recorded, and tax applied, in different ways in different countries. AFME welcomes the guidance as an opportunity to remove some of those inconsistencies. However, the Guidelines can only truly be effective if they are consistently applied across all OECD member countries.

Pass Through Costs

It is AFME's understanding that the OECD only intends that a charge to tax will apply to pure "pass through" costs, i.e. bought in third party services which will be passed on to other MLEs without any bundling or modifying of that service. However, the Guidelines are not entirely clear on this and AFME would welcome confirmation of this point.

AFME believes that the Guidelines would be improved by introducing further clarity in this respect. We are concerned that the recommended approach will be interpreted differently in different countries, and that MLEs will require multiple systems in place to meet the corresponding different requirements.

We would therefore suggest that examples are included within the Guidelines. For example a software licence that is purchased centrally and consumed in other locations would be subject to tax in the country of

consumption as it is not altered. However, a charge for using a trading platform of application (rather than for the use of a software licence which is necessary in order to build the trading platform or application) would not be subject to a tax charge.
We have suggested in the appendix to this submission a number of examples which might be included in the guidance.

Pass Through Costs – Valuation Methodologies

We have noted our understanding that the Guideline's are only intended to apply a tax charge to pass through costs (Guideline 3.5) where the underlying service supplied to the MLE is used in more than one establishment. However, the valuation methods proposed in the Guidelines (see 3.79) assume that the entire recharge made is subject to tax, and the MLE must provide evidence of the value of those elements that are internal or non pass through costs. The assumption that all amounts due under recharge arrangements are in respect of pass through costs is incorrect, and as we have explained below it is often difficult to separate amounts due under recharge agreements in the way envisaged. By default this approach will result in greater amounts of tax being charged than is the intention of the Guidelines.

At 3.65 the draft considers the internal arrangements that an MLE must adopt to support the recharge arrangements. The arrangements may relate to both internal and external costs, and a breakdown between these is not always easily identifiable, for example where systems were put in place prior to the requirement to identify pure pass through costs. The criteria set out at 3.79 will therefore be difficult for an MLE to meet. As an example, a MLE may recharge multiple head office cost codes out under one recharge method but may have no straightforward means of identifying pass through costs within each cost code (other than analysing individual transactions – which would be extremely burdensome).

Accordingly AFME believes that an MLE should be able to rely on a reasonable estimate, agreed if necessary with the tax authorities in the country of the establishment that makes the recharge (in most instances the MLE that received the service from the third party) and that this should be binding on all tax authorities.

As noted at 3.24, MLEs will usually have existing recharge arrangements. In general these arrangements will be consistent with the OECD's Transfer Pricing Guidelines which provides guidance on the 'arms length principle' for the valuation, for tax purposes, of cross border transactions between associated entities. In order to minimise the burden of the new Guidelines, it would seem reasonable for MLEs to continue to use their existing arrangements rather than introduce new recharge arrangements to comply with these proposed Guidelines.

It is not uncommon for tax administrations in different jurisdictions to disagree on the appropriate recharge method and this can lead to increased direct taxation, for example, if deductions are disallowed. In order to minimise the incidence of similar issues that may arise as a consequence of these proposals, it should be clear that it is the MLE who initially receives the 'pass through' cost, to determine the value of the 'pass through' costs. As recognised by the proposal, in some cases, this will be relatively straightforward but in many cases, where the pass through costs are not easily identifiable, the MLE passing on the costs will need to determine a reasonable approximation.

Accordingly we recommend that paragraph 3.79 be amended (in line with 3.69) by adding the following to the existing provision:

"In circumstances where it is not possible to determine the exact amount of the externally purchased service that is subject to a recharge arrangement, the MLE that makes the recharge will be entitled to make a reasonable estimate, using a methodology agreed either generally or specifically with its tax authority, of the value of that externally purchased service which is subject to the recharge arrangements."

Input Tax Deduction

Paragraph 3.74 of the draft provides that in order
" ...to ensure VAT neutrality for the establishment that makes the recharge, general input VAT deduction rules should apply for this establishment in respect of the input VAT on the service or intangible received and subsequently recharged."

In our view the expression "general input VAT deduction rules" is not specific enough, since particularly for international businesses in the VAT exempt sectors there are no general input tax rules that are applied on a global basis. In some jurisdictions, businesses in these sectors are unable to obtain VAT recovery at all; in others there may be a fixed percentage of input tax recovered or a simple pro rata based on the value of outputs. To achieve tax neutrality in this area the Guidelines should be prescriptive in their approach to input VAT deduction - countries implementing the recharge mechanism must give an absolute right to full recovery to the entity making the recharge in respect of that part of the service covered by the recharge rules.

Indeed we would go further and suggest that if a country does not allow a full deduction in respect of the services to be recharged, then in order to avoid the possibility of double taxation there must be no charge to tax in the receiving location.

We would therefore suggest that paragraph 3.72 is amended as follows –
"To ensure VAT neutrality for the establishment that makes the recharge, that establishment should be entitled to a 100% VAT deduction in respect of the input VAT on that part of the service or intangible received that is to be recharged..... In order to prevent double taxation, if the establishment due to make a recharge under these proposals is not granted a full deduction as described above, then the recharge mechanism shall not be applied in the country of consumption."

We suggest that paragraph 3.75 is also amended to reflect the point concerning double taxation –
"It is recommended..... the reverse charge to be made. In circumstances where the establishment making the recharge is denied a full VAT recovery (as described in paragraph 3.72) then the reverse charge mechanism shall not be applied to any recharge to the establishment of use."

Repeal of Existing Legislation

The proposed guidelines s will result in the application of VAT/GST in the country where an MLE 'consumes' a service. There are a number of existing rules applied in EU and non EU countries to achieve this, and it is AFME's view that when the proposed Guidelines are introduced, the existing measures should be removed in order to avoid potential confusion

The existing measures include:

- use and enjoyment provisions; and
- 'force of attraction' and 'intervention' provisions.

Tax Point

Paragraph 3.80 recommends the application of the normal time of supply rules which it summarises to be either:
- Completion of services; or
- Payment; or
- Tax Invoice

The document also suggests that administrations may wish consider an approach where MLE's are required to recharge within a reasonable time and the potential for creating a tax point at the end of each tax period.

It is vital to point out the difficulty with identifying the "completion" date of a specific supply between establishments of the same MLE. The use of an arbitrary date which may not be easily identifiable would remove certainty and could lead to significant dispute. Concern invariably arises where a date which is not linked to an accounting entry is used. In addition, the value of any supply may not be known at the time of "completion".

A tax point at the end of a tax period is also mentioned but is difficult to consider as appropriate. Creating a tax point on a partly completed supply where there is no settlement would generate difficulties in valuation and again lead to lack of certainty.
It is suggested that consideration be given to the calculation of a tax point which is the earlier of:

- Payment;
- Tax Invoice;
- Book entry in the records of the MLE.

The benefit of the adoption of a date which will be identifiable in the accounting records of the MLE will be certainty as to the tax point. The requirement for MLE's to maintain appropriate and accurate accounting records will ensure VAT accounting is consistent with accounting and direct tax reporting.

We recommend that paragraph 3.80 be amended to reflect the following:
"It is recommended that the time of supply for internal recharges be determined as the earliest of:

- *Payment;*
- *Tax Invoice;*
- *Book entry in the records of the MLE."*

Other points

A number of AFME members have expressed concerns around the interpretation of paragraph 3.13 relating to the concept of a Business Agreement. Whilst we understand that this paragraph is not the subject of the present consultation, we believe that the explanatory comments should include a statement to the effect that a written agreement should take precedence over a non-written agreement unless there is clear evidence of avoidance.

We would be happy to discuss our response to the consultation and would be pleased to contribute further as the work develops.

Yours sincerely,

Richard Middleton
Managing Director, Tax and Accounting

APPENDIX

Examples to illustrate application of the Guidelines on place of taxation for supplies of services and intangibles to multiple locations

In scope for supply between establishments of MLE	Out of scope for supply between establishments of MLE
The MLE/Head office incurs cost of a technology licence (that is to be used in different jurisdictions) and charges the cost of this, without making any enhancements, to the different establishments.	The MLE/Head office incurs the costs of a technology licence. The MLE/Head Office enhances the software (provided under the licence) to build an accounting system or trading platform. The MLE/Head Office charges different establishments for the use of the accounting system or trading platform which includes the cost of enhancements, support/maintenance of the system, and the licence charged by the external supplier (which is a cost component) .
Specific legal advice paid for by the MLE/Head Office (as paymaster) which is on-charged directly to a different establishment which benefited and used the advice.	A charge from the MLE/Head Office for overall legal support during a period, which includes an allocation of external legal charges incurred as well as internal costs.
Third Party payroll services provided to the MLE/Head Office for the preparation/production of salary payments across a number of locations. The MLE/Head Office incurs the cost initially and allocates this cost across locations based upon number of employees in the different locations.	MLE/Head office charges other establishments for a complete payroll operation. This advice includes internally generated costs (salaries etc), technology costs (internal and external) and advice from external 3rd parties which is used generally throughout the entity rather than for a specific territory.
Head office incurs external technology development costs for a specific project for a specific location(s) and charges these costs specifically without adding any internal value.	MLE/Head office incurs own internal costs and external costs in the development/management and maintenance of technology systems to be used throughout the entity. These costs are charged to the different locations based upon a cost allocation method (e.g. headcount).