MEMORANDUM

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Subject: BP Group Tax's response to the OECD VAT/GST International Guidelines Consultation (February 2013)

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This represents BP Group Tax's response to the OECD guideline with a particular focus on cross-border supplies of services and intangibles to businesses that have establishments in more than one jurisdiction.

We welcome the opportunity to provide commentary to the draft Guidelines and their intention of seeking to address uncertainty and the risks of double taxation and unintended non-taxation.

We would of course be happy to provide clarity on any of the points raised within our response or participate in any future discussions in respect of this initiative.

Chapter 1 – Core Features of Value Added Taxes covered by the Guidelines

- We acknowledge that the objective of trying to produce a set of Guidelines to achieve neutrality, efficiency, certainty and simplicity, effectiveness and fairness and flexibility is the right approach both for businesses and for Tax Administrations.

- The application of the destination principle, where cross border supplies of services will be free of VAT for the supplier and that any VAT due on the transaction will be charged in the customer's jurisdiction (or the jurisdiction where the service is consumed) continues to be the right approach.

  We acknowledge that the guidelines seek to align the rules in relation to the place of supply of services to the place of supply of goods. However, it should be recognised that although the application of the destination principle for the cross-border supplies of goods provides some certainty, the practical challenges that exist in relation to particular supply chain models continue to prevail, something that is recognised, in particular, by the EU Commission.

Chapter 2 – Neutrality of Value Added Taxes in the Context of Cross-Border Trade

We understand that Chapter 2 is not formally within the scope of this consultation. Notwithstanding, we would like to make the following points:

- We understand that the scope of these Guidelines is Business to Business (B2B) transactions of externally acquired services or intangibles which are purchased and then are to be recharged to the establishment(s) that use the services or intangibles wholly or partially. The Guidelines do not cover services or intangibles that are internally generated or developed within an organisation and which would be recharged within a group structure (para 2.3).

  Certain administrative and accounting challenges could be faced by businesses to the extent that most recharges within a group structure are bundled into a single charge inclusive of external services and internally generated costs. Further examples of challenges are detailed in the 'Other Observations & Comments' section below.

- Guideline 2.3 indicates that "VAT rules should be framed in such a way that they are not a primary influence on business decisions". However, it should be recognised that for certain business sectors, e.g. financial services, charities, not-for-profit organisations, etc., VAT can represent a significant cost and as a result can represent a key factor when commercial decisions are made.

- We understand the principle of the Main Rule and agree that this is the right approach. It is recognised that a Specific Rule will be required in exceptional circumstances but those exceptions should be limited, e.g. the rules that are applicable to the supplies of immovable property.

- Guideline 2.5 refers to a number of approaches to ensure foreign businesses do not incur irrecoverable VAT and provides examples of approaches jurisdictions could adopt to mitigate against this happening. We appreciate that reciprocity agreements between countries are subject to other factors. We believe that the principle of neutrality will be supported if these agreements were promoted and introduced and thus not put foreign businesses at a competitive disadvantage.

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

- Guideline 3.2, we agree with the concept that the jurisdiction in which the customer is located has the taxing right over internationally traded services or intangibles.

- Although not in the scope of this consultation we believe that defining what constitutes a business agreement for identifying the customer is valuable as well as how tax administrations and businesses may approach this. However, this may not be reflected in country legislation that may be implemented subsequent to the publishing of these Guidelines. We are uncertain as to what benefit this may have in future discussions with a particular tax administration.

  We also welcome the wide interpretation of the term 'business agreement' as a contract should not be considered in isolation. We do have a question as to whether it is possible to produce a ranking of relevant documents in terms of their importance, relevance or influence in the event of a dispute.

- Guideline 3.4 stipulates that, in the context of supplies made to a legal entity that has establishments in more than one jurisdiction (a multiple location entity or MLE), the taxing right accrue to the jurisdiction(s) where the establishment(s) using the service or intangible is (are) located. In addition, para 3.17, provides clarity as to the approach to be taken to determine where the services should be taxed, i.e. "…an analysis is required to determine which of the jurisdictions where this MLE has establishments has taxing rights over the services or intangibles acquired by the MLE". We are in agreement with this approach but please note comments relevant to this analysis in the 'Other Observations & Comments' section below.

- Under the two-step recharge method, the first step will follow the business agreement between the external supplier and the MLE. The taxing rights to the MLE are allocated to the jurisdiction of the customer establishment that enters into the business agreement with the supplier on behalf of the MLE group. Under step two of the recharge method, there is then an expectation to recharge an amount to the other establishments to the extent of their use of the services.

  We assume that the above will also include Single Legal Entity groups. For example, an entity with a single Head Office in an EU Member State and which also has multiple branches in other EU Member States. Under the proposed method the Head Office will be required to recharge external costs attributable to a particular branch based on its' use of the services. In the EU at the moment these charges do have to be made as they are disregarded for VAT purposes. This new guideline will place an additional accounting and reporting for businesses including VAT invoices where required (para 3.20). If businesses are fully taxable then no VAT or tax will be collected in the jurisdiction of the branch and we therefore question the scope of the recharge. i.e. should it cover fully taxable MLEs and SLEs?

- If the customer establishment (which has the business agreement with the supplier) does not recharge to the establishment that uses or consumes the services, then the tax administration will be entitled to tax as if the recharge has been made. This is likely to raise valuation issues and in addition we are not sure whether there are Transfer Pricing implications (para 3.21).

- The use of an apportionment or allocation method for the recharging of services used by establishments could generate debate between businesses and tax administrations (para 3.77). Extending the scope in regions such as the European Union, could generate further disputes between businesses and tax administrations, and is this proportionate to the issue being addressed by these guidelines?

- The unbundling of recharges relating to external services as opposed to internally generated services will result in a potentially different tax treatment in the country where the establishment that uses the services is located. If this is the case, there is an additional burden in having to split out such services on invoicing (i.e. to enable the recipient to self-charge/reverse charge where required). There could also be a debate with the tax administration as to what is an external service versus an internally generated service. Is there an obvious solution to this point? Some clarification would be welcome.

- Under the Specific Rule, there is a statement that this rule could be justified only when the analysis suggests that it would lead to a significantly better result that the use of the Main Rule. It is not clear what the definition of "significantly better result" is and as a result this could be open to interpretation both by businesses and tax administrations (para 3.88).

Other Observations & Comments

The following are specific observations and comments made by BP Group Tax colleagues from around the world.

India

- The reverse charge can apply to an Indian branch on international services and there is no settlement provision, therefore if the reverse charge is not applied, then businesses can be subject to penalties and interest. The size of the penalty can be reduced but rarely to zero. This is a common theme in AsPac region and therefore although the recharging mechanism may generate no additional taxes it could generate additional areas for challenge for failure to comply with additional reporting requirements. One solution could be to remove fully taxable recipients from the reverse charge reporting requirements, where existing legislation allows

- In-country branches seen as one entity and therefore any recharge-in can only be made to the central registered branch. This merely highlights the challenges that countries may face in implementing the guidelines into their existing legislation or local practice.
- VAT and GST (local and federal) being introduced in the future and model will mean local and federal VAT will be in operation simultaneously. One challenge will be that India is not the only country looking to introduce VAT/GST and countries will be at different stages of implementation of local VAT/GST legislation and existing interpretations will vary meaning on-going uncertainty once OECD guidelines issued with the additional risk of "cherry picking" by certain countries.

US

- Recognise that this is a noble initiative and broadly agree with the principles.
- We thought it would be worth highlighting a similar initiative (to the OECD guidelines) launched by the Federation of Tax Administrators (FTA) in the US. It is a body represented by the 50 States which a few years ago issued guidelines for State tax administrations to follow when issuing tax legislation in relation to Mineral Oil Tax. The guidelines, similar to the OECD, are not compulsory. This has resulted in individual States cherry picking elements leading to further complexity and non-standardisation for businesses. A similar adoption of the guidelines by OECD members will be counter-intuitive to the purpose and objective of the OECD guidelines. Therefore, there has to be a strong message of wanting to retain a standardised version, as well as a method of monitoring how countries implement the guidelines, to measure the success or not of the OECD's priorities.
- The exclusion of internally generated services from the scope of the guidelines will create further complexity and uncertainty (a two-tiered structure), for businesses and tax administrations.
- If for example, the US was to adopt the OECD guidelines then this could affect business profit margins as sales/use tax becomes chargeable/accountable and will represent a cost (as it is not deductible like VAT or GST).
- It is recognised that systems implications for businesses could be significant if the guidelines are not strictly interpreted by Tax Administrations (as will result in multiple variations).

Spain

- A positive document with clear messages and good examples.
- If applying the HO to branch recharge what about local arrangements where entity to entity are disregarded such as VAT grouping in Spain. We would like to avoid scope creep resulting in removal of existing simplifications/benefits.
- If recharging, what should the document to support the recharge look like? It is not an invoice and existing systems are not structured to produce alternatives.

Germany

- Single Legal Entity – Ignores EU existing legislation and guidelines and would result in an impact on master data, valuation methodology, additional reporting requirements. Appears to be a burden as no tax payment to Tax Administration will be generated in the country where the services are consumed (i.e. SLE is fully taxable for VAT purposes).

South Africa

- Fully taxable entities (for VAT purposes) can disregard services received from outside of South Africa (i.e. treated as zero rated and therefore the reverse charge does not have to be applied). A simplification measure which could be applied to the OECD guidelines. This seems to be very sensible approach being taken by this tax administration and one which we believe is applied in other countries. This demonstrates that it is a workable solution, reducing the administrative impact on businesses and the tax administrations, where there is no risk of loss of revenue to the tax administration. We would welcome such an approach being reflected within the OECD guidelines.

- Recharges made from HO to branch (within same entity), cross border may provide certainty as to the place of supply of those services and where VAT should be accounted. However, this recharge could create an impact in relation to withholding taxes. This could result in no VAT cost but a significant cost to the group where the withholding tax cannot be recovered. Has this been considered by the OECD as part of its review? We understand that the same principle could apply to some South American countries. Clearly where the objective is to remove double taxation, we would hope that the VAT/GST guidelines would not trigger additional tax burdens outside of the VAT/GST regime.

United Kingdom

- We welcome the reductions to the exceptions in respect to the main rule, if implemented systematically by all OECD members and non-members.
- We recognise that the guidelines would drive efficiency in respect of ERP (Enterprise Resource Planning) systems with standardised format, but transitional stage would be challenging for businesses as country implementation of the guidelines could be over a number of years.
- We recognise that this could reduce the level of manual invoicing activity, which is an area of risk that businesses would like to see achieved.
- There is a concern around the valuation of the recharge and on what basis (how to get consistency in approach for a multi-national company)
- Where a branch if fully taxable (for VAT purposes), could that branch not be required to apply the reverse charge?
- There is the focus on external charges, stripping out internally generated, which could result in separate billing processes and challenges in stripping out the internally generated (how are they defined) when part of an overall more complex service offering to the branches.
- For regions such as the European Union, has there been consideration of the guidelines and the impact on other regulatory reporting requirements e.g. ESLs in the EU.
- Certain industries follow legal structures such as a branch arrangement for business purposes and not tax driven. Guidelines will impact those structures adversely. To what extent has this been taken into account in developing the guidelines? The approach of fully taxable recipient branches not being required to make a reverse charge VAT adjustment, would ensure there is equity of treatment with businesses that do not operate a branch structure.
- A question exists around the methodology in terms of allocating external services i.e. HR services. Impact of Tax Administrations in the countries of the recipient (branches) imposing a higher charge (methodology) could result in double taxation for the branches, where those businesses not able to fully recover VAT.
- The objective of the Guidelines is clear but is this going to provide the certainty and remove the double taxation or create further uncertainty? What is the scale of the “mischief” that the guideline is trying to address and are the guidelines a proportionate response?
- There needs to be recognition that Tax Legislation in a country will state a course of action but the practical approach may differ. The OECD should encourage stricter interpretation to remove such uncertainties.
- Tax administrations are encouraged to allow cost allocations or apportionment methods but should these be agreed in advance or allow existing processes to avoid new methodologies purely for VAT purposes?
- Examples in 3.95 are helpful but there is still scope for uncertainty. For example how floating assets such as offshore rigs or installations should be regarded in terms of immoveable property?
- The Transfer Pricing adjustments and relationship with branch recharging methodology. To what extent should adjustments be made for VAT purposes, if for example year end TP adjustments are made?
- There is an example in terms of the European Union and the interpretation of the Specific rule around immovable property and potential cashflow or absolute cost for recipient HO/branch. For example where you have a UK property. Charge from UK supplier (providing services connected

to the immoveable property) to German HO (plus UK VAT). Is that recoverable by German HO (under the 8^{th} Directive refund mechanism)? Alternatively, does the recharge to UK branch then preclude the right of recovery for German HO with the requirement for it (German branch) to be VAT registered in UK or can UK branch just recover the UK VAT charged by UK supplier through its own UK VAT registration?