May 2013

**CBI Response to the OECD's invitation for comments on the International VAT/GST Guidelines**

We greatly welcome the opportunity to participate in the OECD consultation process by providing comments on the International VAT/GST guidelines.

The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

## GENERAL COMMENTS

We recognise the importance of addressing uncertainty and the risks of double taxation and unintended non-taxation that result from inconsistencies in the application of VAT/GST to international trade. This is particularly the case given the global spread of VAT/GST over the last 50 years, the complexity of current VAT/GST systems which are difficult to administer for both business and governments, and the growing interaction between often incompatible VAT/GST systems in the context of the rapid globalisation of economic activity where the scale and complexity of transactions has also significantly increased.

Therefore, we strongly support guidance which aims to encourage neutrality, consistency and certainty and the reduction of risk for both business and governments, whilst being mindful of the need for increased simplification and proportionality in administering the tax. Both business and government have a major interest in a simple and efficient international VAT/GST system which allows the proper functioning of the global economy and in a manner which safeguards tax revenue. In this respect, we also welcome and appreciate the approach taken by the OECD in facilitating the exchange of views and information between business and government acting in partnership, and engaging OECD members and non-OECD members alike.

We would be pleased to further discuss or clarify any of the comments set out below.

The guidelines note, quite rightly, that businesses play an important role in the collection of VAT/GST (paragraph 7). However, we feel that this does not sufficiently underline the significance of businesses' responsibility in the functioning of the tax system - VAT/GST is a major revenue raiser and is relatively easy and cost effective to collect because businesses act as unpaid tax collectors on behalf of governments. We would be pleased to see this point given further prominence in the guidelines.

## DETAILED COMMENTS

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

- The overarching purpose of a VAT is described as to impose a broad-based tax on final consumption by private individuals and entities involved in non-business activities (paragraph 1.2).

  Although it is recognised in Chapter 2 that the burden of value added taxes may lie with some businesses where explicitly provided for in legislation, in reality many businesses (eg, financial service, insurance, healthcare, education etc) fulfil the role of the final consumer in current VAT/GST systems, for various VAT technical and policy reasons. Given this reality, it may be helpful to clarify this point in Chapter 1, particularly since the proposals for multiple location entities (MLE) in Chapter 3 will have a

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considerable impact on some of these exempt or partly exempt businesses.

- Regarding the destination principle, paragraph 1.12 states that implementation with respect to international trade in goods is relatively straightforward and generally effective due to the existence of border controls or fiscal frontiers. Similar comments are also included in Chapter 3 (eg, paragraphs 3.1 and 3.2).

  However, whilst the place of supply of services poses numerous potential issues, particularly in an environment where an increasing number of services are delivered electronically to highly mobile customers, there certainly remain many areas of difficulty regarding the taxation of the trade in goods, even if the transactions themselves are generally more visible and auditable – eg, qualification issues of goods versus services, composite supplies, complex chain transactions etc.

  As such, whilst we recognise that the VAT treatment of cross-border services merits prioritisation, the cross-border supply of goods is not without issue.

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

We recognise that Chapter 2 is not formally within the scope of the current consultation exercise. Nevertheless, we believe there are two points worth noting on the neutrality guidelines:

- Reciprocity is covered in paragraphs 2.30 to 2.33. Undoubtedly, this is a difficult subject from a political perspective. However, it is clear that from a business perspective the granting of refunds to foreign entities on a conditional basis diminishes the principle of neutrality and negatively impacts the effectiveness of the VAT/GST system.

- Groups of countries are covered in paragraph 2.34. Whilst it may be acceptable in theory for a group of countries to operate different systems in terms of the treatment of group members and non-group members, in practice this would potentially create administration difficulties for businesses with activities in both group and non-group countries and also for the relevant tax authorities. Therefore, we would urge and encourage the uniform application of a common global framework in order to avoid issues associated with a single tax, multiple system approach.

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

- The recharge arrangement appears to be a more appropriate methodology than the direct use of head office methods, given that it seeks to achieve MLE taxation according to the destination principle and in a manner which builds on existing regulatory and accounting rules rather than imposing new VAT-only requirements on suppliers, customers and tax authorities.

- Our understanding is that the recharge arrangement applies only to externally acquired services and not to internally generated or developed services (paragraph 3.23). This is an important distinction, given our earlier comments regarding those businesses which are in the position of acting as the final consumer and for whom the taxation of MLEs will most likely represent a significant additional cost.

  That said, it is not entirely clear exactly what is envisaged here – eg, the taxation of externally acquired services which are passed on in their original and unmodified state to other MLE establishments, or a wider scope to tax externally acquired services which form part or cost components of more complex internal supplies of services. Clarification on the applicable definition and scope of the arrangement would be helpful.

  Should the arrangement include the taxation of constituent parts of internal services that were acquired externally, it should be noted that the identification of such elements may be extremely difficult to achieve in practice and potentially very costly to track given the scale and complexity of the relevant transactions. Depending on the scope of the arrangement it may be advisable to consider further business examples to illustrate the potential hurdles to simplicity and efficiency – we would be pleased to provide additional scenarios if required.

- One possible way of reducing the potential burden of identifying and tracking external purchases for MLE taxation purposes would be to ensure that businesses with a full right to input VAT deduction are not required to account for a reverse charge on any recharge. This possibility is mentioned in several places within the guidelines and is fully endorsed by us – indeed where no tax revenue is at stake such a simplification would seem to suit both business and government. A number of countries already apply such a best practice – eg, Canada, New Zealand, South Africa etc.

By contrast, a disproportionate compliance burden may then rest with a smaller business population and it may be appropriate to consider whether there are ways and means of reducing such administrative burden for the impacted businesses.

As noted in the OECD's Lucerne Conference Communiqué, simplification of VAT systems, providing businesses with certainty and clarity whilst minimising compliance costs are key elements in the effective functioning of VAT.

- One final point regarding MLE taxation – from a business perspective it would seem important that governments commit to a single methodology and do not combine methodologies, as referred to in the Background on page 5 – eg, a general recharge arrangement methodology applied, but with a direct use carve out for services which are rendered locally where the supplier and customer are established in the same jurisdiction. Such a procedure is currently applied in some OECD member countries and creates disproportionate compliance burdens in operating different systems for the same supplies (which ultimately should be taxed locally whatever methodology is employed), as well as potential inconsistencies with the way other tax and regulatory requirements are administered.

- The use of a specific rule for certain transactions, such as services related to immovable property, should be limited as far as possible and only where an exception would produce a significantly better result than the main rule – as set out in paragraphs 3.87 and 3.88. However, the use of such a rule should also be applied consistently between jurisdictions if it is to be effective in promoting certainty and reducing double or non-taxation – current issues with specific rules concern not just the scope of the rule, but the difference in interpretation between jurisdictions.

  Businesses support the use of a specific rule which allocates taxing rights in a different manner than that envisaged by the main rule where the services have a very close, clear and obvious connection with immovable property and where specific immovable property is the subject matter of the service or, to put it another way, the immovable property is the object of the supply.

  We note that it would be difficult to prescribe what services fall within the scope of a specific rule, but general rules can be recommended. However, current VAT/GST systems struggle not only with whether services are sufficiently connected to immovable property, but also with how immovable property should be defined. We recognise that it would be difficult to prescribe what immovable property is, but without such a definition (or, alternatively, a definition of movable property) this area is likely to continue to cause difficulty.