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Dear Sir,

As part of the process of drawing up its Guiding Principles for the application of VAT to international trade, the OECD has launched a public consultation on four proposed new elements for the Guidelines, these relating mainly to the place of taxation of international supplies of services and intangibles to businesses with establishments in several jurisdictions.

As a professional entity grouping together all the credit institutions in France, the Fédération Bancaire Française (FBF) welcomes the OECD's initiative in drawing up international guiding principles relating to VAT and would like to make some comments.

From the point of view of French banks, the VAT system as applied across countries can sometimes, because of its lack of harmonisation, represent a source of legal insecurity and an area of tax friction – in particular for the banking sector which is partially VAT exempt. In this respect, we fully support the targets set out in the draft preface to resolve the doubts and risks of double taxation or unintended non-taxation resulting from inconsistencies in the application of VAT to international trade.

By way of introduction, we should like to point out that the European Union has built up a detailed body of rules with regard to VAT and it is important that the OECD recommendations mesh coherently with the principles applying in the European Union.

At the moment, the OECD's work covers the fundamental principles of VAT applied to international trade (Guidelines on VAT neutrality) and the definition of the place of taxation of international trade in services and intangibles. Also envisaged are guidelines on the place of taxation of cross-border supplies of services and intangibles to final consumers, as well as anti-abuse measures and provisions concerning mutual co-operation and dispute settlement.

To begin with, it would be useful for the OECD's work to be extended to the principles of VAT deduction. This is a big issue for French banks because, as you know, banking and financial transactions are exempt from VAT, apart from custody and securities management services, or the rental of safe deposit boxes which remain liable. The exemption of financial activities means that banks are unable to recover all or part of the upstream VAT on their operations, and this results in a "remanence" phenomenon (hidden VAT) which generates far from negligible costs, is contrary to the principle of VAT neutrality and is accentuated by restrictive rules for calculating rights to deduction.

As they stand, the Draft Guidelines on the place of taxation for cross-border supplies of services and intangibles to businesses carrying out their activities via establishments in more than one jurisdiction prompt a number of comments on our part.

With regard to the Guidelines, the draft proposes that taxing rights should accrue to the jurisdiction(s) where the establishment(s) using the service or intangible is (are) located (principle 3.4). When the services are used by one or more establishments other than the establishment that entered into the business agreement, it is proposed that internal recharge arrangements be used as the basis for allocating taxing rights over services or intangibles to the jurisdiction(s) where the establishment(s) using them are located (Guideline 3.5). In this case, internal recharges are treated as consideration for a supply within the scope of VAT.

It is stipulated that this Guideline does not deal with the VAT treatment of internally generated or developed services or intangibles, or with the value that is added internally to services or intangibles acquired from an external supplier. In our view, this breakdown could prove very complex in certain cases, and the OECD ought therefore to make its position on this question clearer.

Also, where recharge arrangements are concerned, it is stated that multiple location entities may have recourse to cost allocation or apportionment methods (allocation keys) which include a certain degree of estimation or approximation of the actual use of the service by each establishment.

It seems to us that the OECD should pursue its reasoning through to its logical conclusion and tackle the question of deduction rights. The principle of VAT neutrality implies the most efficient possible recovery of VAT.

At the present time, however, French rules on the right of deduction and, in particular, the rules for determining the general deductible proportion, give partial taxpayers, including banks, only a very limited right to recover upstream VAT. In addition, moreover, to the defects in its method of calculation, the deductible proportion of VAT is not necessarily the most appropriate method of cost allocation and thought needs to be given in the OECD to the possibility – for VAT neutrality purposes – of using relevant economic allocation keys for expenditure relating to various different activities of which some are liable to VAT, while others are exempt and do not therefore give rise to deduction rights.

We are entirely at your disposal for any further information you may need and are available to work with your services in greater depth on the subject of VAT, especially in the context of a meeting.

Yours faithfully,.

Blandine LEPORCQ
Head, Tax Department