FIDAL

By way of a general comment, we should like once again to commend the quality and the thoroughness of the work carried out by the Group on the International VAT/GST Guidelines, which is making it possible to formulate an essential framework for ensuring equitable international trade and fair collection of tax.

We shall make no particular comment on either the Preface or Chapter 1 (*Core Features of Value Added Taxes Covered by the Guidelines*), which strike us as comprehensive and reflective of all the overall considerations already addressed on these topics.

We shall focus more particularly on Chapter 3 of the Draft, insofar as it explores the method to be used in respect of an outside service provider supplying services or intangibles to "multiple location entities" (hereinafter "MLEs").

We find that the chosen orientations would seem conducive to equitable and efficient application of the destination principle, but we should nevertheless like to make the following comments. These comments do not purport to provide solutions to the challenges that arise in taxing the supply of services or intangibles, but to identify certain avenues for consideration.

I. 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.

This Guideline transcribes the destination principle, which governs VAT/GST-related aspects of international trade and stipulates that tax should be paid in the State where the good or service is consumed.

In our opinion, the notion of establishment will ultimately have to be defined more clearly if this Guideline is to be applied properly.

Indeed, the Draft Guideline stipulates initially that "[r]egistration for VAT purposes by itself does not constitute an establishment". However, other questions may arise:

- Should it be concluded from this that the absence of registration for VAT provides *de facto* evidence of the absence of an establishment?

- Should the concept of an establishment be analysed from the standpoint of strictly legal notions (see the reference to the notion of "branch" on page 5 of the Draft) or with reference to criteria inherent to VAT (substance, facilities, personnel, etc.)?

  From this standpoint, we feel it would be useful to undertake work in the future, along the lines of the OECD's explorations of corporate taxation, so that all States could benefit from a common point of reference and thereby avoid situations of double taxation or unintended non-taxation according to

whether an establishment is or is not recognised for VAT purposes in a given country.

II. 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.

This Guideline seeks to put Guideline 3.4 into practical application.

Our thoughts on this are as follows:

- **1st step: taxing rights allocated to the jurisdiction in which the customer that entered into the business agreement has its establishment**

  It is our understanding that the first step in determining where the supply of services or intangibles being supplied in international trade is to be taxed consists in **identifying the customer that has entered into a business relationship** with the supplier.

  Accordingly, as indicated in paragraphs 3.9ff of the Draft, the term "business agreement" need not be construed as a formal document / contract but may take a number of different forms: exchange of correspondence, order slips, invoices, etc.

  It should be noted, however, that there sometimes arise situations in which a variety of different components of a business agreement may be made out to various establishments within a single MLE, in such a way that it may be difficult to ascertain which establishment is the customer under the agreement.

  For instance, the order slip may be made out to a first establishment, whereas the various aspects of the transaction may have been negotiated by another of these establishments, or the invoice may have been sent to yet another one, *e.g*. the establishment that uses the service.

  From this standpoint, we would raise questions about:

  - The advisability / feasibility of establishing a hierarchy (or of urging national legislations to insert a hierarchy) amongst the various elements by which customers can be identified;

- The tax responsibility of the service provider, or of the customer, in designating the customer establishment under the business agreement (in the jurisdiction where VAT would be due before recharges to other user establishments);

- The liability of the invoiced establishment (user, partial or not) in the absence of any subsequent recharging;

- The need to identify the customer under the business agreement if the user establishment(s) is (are) are readily identifiable; in this particular case, the "direct use method" strikes us as the easiest to use and is probably the most appropriate as well, in terms of the destination principle, but tax neutrality as well (*e.g.* assuming a non-user client under the business agreement with no entitlement to full recovery).

- **2nd step: recharging agreement**

  In order to enable taxation in the country where the service or intangible is used, the Draft calls for the institution of internal recharging within an MLE: the customer establishment would thus recharge user establishments for the service (applying the VAT of the jurisdiction in which the user establishment is located, or applying a reverse-charge mechanism).

  More specifically, paragraph 3.21 urges that in principle VAT be applied even if no recharge arrangement is in place, which is ultimately tantamount to considering that for VAT purposes such an agreement is compulsory.

  This prompts the following thoughts on our part:

  - As indicated, such recharging – or at least cost allocation – arrangements are frequently instituted within MLEs (*e.g.* for assigning expenses between headquarters and its establishments), and consequently systematic recharging, *i.e.* service by service, between establishments is not always necessary.

  - Consequently, it seems to us that to impose such recharging (for example, in respect of services not covered by these more general agreements) may, under some circumstances, run counter to the MLE's underlying economic logic and indirectly saddle it with a certain form of interference in the management of its internal flows. There are in fact circumstances that could justify (with regard to the applicable transfer pricing principles, for example) keeping expenses within an establishment even if they benefit other user establishments (*e.g.* start-up expenses for an activity, expenses incurred by headquarters / the "entrepreneur", etc.). It is possible to imagine situations in which

compulsory recharging for VAT purposes could generate risks with regard to other taxes. We feel that a more moderate approach on this point would be preferable in certain situations.

- We should also like to draw your attention to the positions under the respective legislation of certain countries with regard to analysing operations carried out within a given MLE (*i.e.* a legal entity having multiple establishments). France, for instance, considers that services rendered between establishments belonging to one and the same legal entity should be considered outside the scope of VAT insofar as they constitute "services rendered to itself". It is therefore to be feared that there would be inconsistencies between jurisdictions, with some States deeming that VAT is payable to them and others denying the existence of a service subject to VAT, which would complicate MLEs' management of their internal operations with respect to the principle of legal security. In our view, this calls for examining an establishment's status with regard to VAT at an earlier stage in the process (see above). Should it be considered, as the Draft would suggest, that an MLE's various establishments are independent / autonomous with regard to VAT (in line with the assumption that is made with regard to corporate tax), or should it be considered rather that they form one and the same legal entity, thereby making it impossible to conduct economic operations amongst themselves that would be subject to VAT? We feel that this subject should be explored comprehensively in order to formulate a clear guideline that could govern all of the rules applicable to establishments.

- Lastly, we should also like to see some thought given both to the consequences of an absence of recharging and to the powers local authorities might have to assess the need for such recharging. Indeed, the purpose of the proposed recharging method is in fact to simplify the administrative chores of businesses and the management of their tax data relative to the so-called "direct use method". Care should therefore be taken that the requests of various local authorities do not ultimately cause taxpayers to have to collect and analyse this same information after the fact. In our view, requests for information from the various authorities ought to be commensurate with the intended purpose, *i.e.* limited to what is necessary in order properly to apply the destination principle. Accordingly, it should be recommended that the Draft should specify that no discussion over quantity should ultimately cause any reconsideration of the destination. In our view, identical principles should apply to exchanges of information between States so that internal operations by MLEs can be conducted securely.

III. IN CONCLUSION

We endorse the Draft as presented by the Group insofar as we feel it is best suited to adherence to the destination principle and therefore to awarding each State the tax revenue relating to services consumed within its borders.

Nevertheless, and as mentioned above, the proposed solution assumes that States explore the notion of establishment from the standpoint of VAT in order to be able to (i) identify and (ii) distinguish between those that constitute customer establishments and / or user establishments.

Likewise, it would be preferable for the action of the authorities to be restricted with regard to (i) powers invested in them in connection with supervising operations within an MLE, and (ii) the sanctions that might apply in the absence of recharging to the proper establishment.

Lastly, we believe that certain simplifications and additional flexibility would be appropriate, *e.g.* by authorising use of the direct use method when doing so would pose no particular difficulty.

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Yours faithfully,

Laurent Chetcuti
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Hauts de Seine
Associate Director