OECD International VAT/GST Guidelines

Draft Consolidated Version

Response of the Law Society of England and Wales of 03 May 2013

The Law Society of England and Wales is the independent professional body, established for solicitors in 1825, that works globally to support and represent its 166,000 members, promoting the highest professional standards and the rule of law.

Executive Summary

The Law Society of England and Wales ("The Society") welcomes the opportunity to comment on the draft consolidated version of the OECD International VAT/GST Guidelines issued in February 2013 (the "Guidelines"). The Society notes that the Guidelines as issued represent only part of the full set of guidelines proposed to be issued by the end of 2014 and looks forward to the opportunity to comment in due course on other aspects of the guidelines in due course.

The Society welcomes the OECD's approach in seeking to develop the Guidelines with a view to addressing issues of uncertainty in the application of VAT and similar taxes to international trade, in particular with regard to trade in services and intangibles.

On a European Union level, over recent years, steps have been taken to seek to amend and update the VAT rules to take account of market developments, such as the increased cross-border supply of B2C services due to developments in technology, and to simplify the operation of the tax system, for example through revisions to the taxation of B2B services to move most such services to a basis of taxation in the Member State of receipt. Although now largely agreed subject to implementation, this has been a lengthy process. In addition, circumstances still remain where double taxation or double non-taxation may arise, albeit now largely in situations where tax authorities' interpretation of the relevant rules differs.

Given these developments and ongoing challenges at an EU level alone, the Society considers that achieving a broader alignment of approach in the scope and operation of VAT and similar taxes across a wider set of jurisdictions and tax systems will be a significant challenge, albeit one that merits some attention. This is a situation further exacerbated by the financial position of many governments, which have limited resources to consider change, and may well prove unwilling to adapt and update rules in a way that would lead to an erosion of taxation revenues, particularly in the field of indirect taxation which is often a significant contribution to national budgets.

The Society's specific thoughts and comments on certain of the sections comprising the Guidelines are developed further below.

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Chapter 1: Core Features

1. The Society broadly agrees with the description in Chapter 1 of what would amount to a typical VAT system, in terms of a broad based tax on final consumption, with a staged collection process.

2. The Society notes, however, that certainly under the EU VAT model, the treatment of certain businesses as final consumers, such as financial institutions like retail banks and insurance companies, does represent a move away from the model proposed by the OECD of taxation being borne by private individuals and non-business entities. The EU approach is, therefore, difficult to reconcile fully with the model set out in Chapter 1 (albeit that this is addressed later in the Guidelines).

3. The Society agrees in concept with VAT being a tax that should operate by reference to a destination principle, rather than an origin principle. However, at a practical level, it may well be difficult, particular in the context of international supplies of services and intangibles, to identify precisely where the destination of supply (and by implication the place of consumption, although these two concepts may not always align) exists. Providing clear rules for the operation of the destination principle, by reference to "real world" transactions, is therefore fundamental to the satisfactory operation of a VAT or similar tax based on that principle.

Chapter 2: Neutrality

4. With regard to Guideline 2.1, as noted in paragraph 2 above, the treatment of certain businesses as final consumers presents challenges, and should be avoided where possible. The current language, allowing this treatment to be adopted "where explicitly provided for in legislation", although seeking to ensure a degree of legal certainty for affected business taxpayers, does not perhaps go far enough. It might be argued that specific circumstances where it is appropriate to treat businesses as final consumers should be set out in the Guideline to ensure greater uniformity of approach between jurisdictions. The Guidelines should also perhaps consider the possibility of affected businesses being permitted to "opt to tax" their supplies, for example in respect of a bank providing services to business customers where those business customers can recover VAT charged to them by that bank, thus avoiding generating unnecessary irrecoverable VAT in the supply chain and more closely following the Chapter 1 model.

5. Guideline 2.2 is welcome, but we query whether matters such as the exemption of certain transactions from the scope of taxation, or the provision for zero or reduced rates of taxation, should in addition be explicitly addressed here. We also query whether areas such as the need for neutrality in taxation of similar transactions provided both by businesses and non-businesses, such as government or statutory operators, should be considered.

6. With regard to Guideline 2.3, we query how this can be measured in practice. Certainly for businesses for whom VAT is a real cost, VAT may be a decisive factor in choosing one course of action rather than another, for example whether to continue to undertake certain services internally via employees or to outsource the provision of those services to a third party, in a situation where the fees charged by the third party would give rise to irrecoverable VAT that is not offset by the greater commercial and business efficiencies that may be achieved through outsourcing. This is addressed to some extent in paragraphs 2.54 and 2.55, although it is not immediately clear why the business decisions in paragraph 2.55 should not be taken into account.

7. The approach proposed in Guideline 2.4 should not be questioned, although practically the compliance and administrative burdens faced by a foreign business dealing with a local VAT system in addition to their home state tax system may prove challenging. Of

course, to the extent those two systems were aligned in approach via application of the Guidelines in each jurisdiction, this could reduce such issues. See also Guideline 2.6 in this regard.

Chapter 3: Determining the place of taxation

8. With regard to Guideline 3.1 and the related discussion, the concept of "destination" may, as mentioned above, not always align with that of "consumption". For example, with international businesses receiving cross-border supplies, where those supplies are consumed by a branch in a different jurisdiction, the place of such consumption may not be clear. We wonder, therefore, whether the Guideline itself should specifically reference "destination".

9. Guidelines 3.2 and 3.3 seem sensible, although we wonder in Guideline 3.3 whether "normally" creates a degree of uncertainty of application of the guideline, which should be further developed. The concept of "business agreement" is also not clear, and may not take account of real world situations, e.g. where discussions and negotiations have taken place over a period of time, or have been superseded, or indeed where group procurement functions are potentially negotiating on behalf of a number of group entities which may then separately decide whether or not to receive the relevant services. The discussion in paragraphs 3.11 to 3.16 suggests that businesses may need to review and retain potentially significant amounts of documentation, in a variety of forms, to analyse where the business agreement has been concluded.

10. Guideline 3.4, and references to the place of "use" by a multiple location entity, could, we suspect, prove difficult to apply. For example, as noted in paragraphs 8 and 9 above, where services are procured by an entity in one jurisdiction and put to use by branches in other jurisdictions, is the place of ultimate use necessarily appropriate as the basis on which VAT should be applied, which we submit could lead to complexity and uncertainty around when and where a liability to VAT arises? Or should instead the procuring group entity be treated as receiving the services solely in the jurisdiction from which those services are procured, with that jurisdiction, therefore, being the destination of those services for the purposes of that initial supply, and with any onward supply to another jurisdiction then being viewed as a further supply for VAT purposes by the procuring group entity, with the place of use of that further supply being the recipient jurisdiction?

11. Guideline 3.5 suggests the latter "two step" approach is to be followed, although it is not clear from the discussion in paragraphs 3.19 to 3.22 as to which entity is responsible for VAT to the extent there is an actual or deemed recharge to the jurisdiction of use, and what impact this would have on the position of the group procuring entity, which may in the meantime have accounted for VAT in its jurisdiction. It would also be helpful to understand what basis is appropriate for calculating any deemed recharge, for example whether this would be in line with the arm's length principle adopted for transfer pricing and branch profit allocation purposes, and in what circumstances would an actual recharge arrangement not be considered appropriate as a basis for the application of VAT. Examples 3 and 4 in Annex 1 suggest that depending on the contractual framework, transactions involving similar performance may well give rise to different VAT outcomes, notwithstanding the application of the Guidelines.

12. We note the proposal in paragraph 3.38 and later paragraphs to minimise burdens on suppliers by using a reverse charge mechanism requiring the customer to self-account for the VAT concerned, and consider this represents an appropriate basis for operating the proposed system, although does not entirely deal with the question of when and where VAT liabilities will ultimately arise.

13. We also note the discussion concerning the approach of tax administrations, and query whether existing penalty systems that operate where a reverse charge is not correctly

applied, for example that of the UK, meet the approach suggested in footnote 40. We also suggest that the differing positions that tax administrations may adopt in relation to whether there has been use in their respective jurisdictions needs to be considered.

14. With regard to Guideline 3.6, some further clarity in limb (b) as to what amounts to a "significantly better" result would be helpful – presumably this means a more appropriate allocation of tax between relevant jurisdictions by reference to use, rather than merely more tax revenues for a particular jurisdiction concerned. Given Guideline 3.6 proposes circumstances in which divergence from the Main Rule may be appropriate, such circumstances will need to be clearly expressed to ensure legal certainty as to when divergences may occur. The examples set out, for example in relation to restaurant services and sporting events, are helpful but not exhaustive, and leave a broad margin of appreciation for jurisdictions to seek to disapply the Main Rule.

15. Guideline 3.7 seems appropriate in the context of immovable property, although further guidance will be needed on how a "very close, clear and obvious link or association" might be found to exist, such that related services are treated as located in the immovable property's jurisdiction. For example, whilst it might be clear that legal services relating to advice on the acquisition of a property should be treated as having such a link or association, what is the position where such legal services relating to financing the acquisition of such a property? Where a lawyer provides services in relation both to an acquisition of immovable property and a related financing, how should this be dealt with – by way of apportionment of the relevant professional charges? In addition, in circumstances where the immovable property in question is neither located in the jurisdiction of the supplier nor of the customer, how will VAT be collected, and from whom?