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ICAEW TAX REPRESENTATION

OECD INTERNATIONAL VAT/GST GUIDELINES

Comments submitted on 2 May 2013 by ICAEW Tax Faculty in response to the OECD consultation document *OECD International VAT/GST Guidelines* published on 4 February 2013

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The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall, Moorgate Place
London EC2R 6EA UK
icaew.com/taxfac

T +44 (0)20 7920 8646
F +44 (0)20 7920 0547
E taxfac@icaew.com

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document *OECD International VAT/GST Guidelines* published by the OECD on 4 February 2013.

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.

5. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

7. Overall, ICAEW welcomes the concept and aims of these guidelines. However, we do not think that as currently drafted Chapter 3 is satisfactory. The guidelines are either too broad or insufficiently clear. As a result, tax authorities are likely to put forward their own solutions rather than adopt a consistent approach as envisaged by these guidelines.

8. In order to support the adoption of the guidelines an economic assessment should be made at some stage of the proposed impact of the proposals and in particular on the financial services sector. It should be recognised also that, particularly in the financial services sector, the use of branches is often adopted for regulatory and capital sufficiency purposes.

9. The guidelines have been written using internal charges as a basis of allocating the taxing rights. While we broadly support the use of this method, we believe that the additional cost and administrative burden for businesses needs to be understood prior to the publication of these guidelines. Whichever method is ultimately decided upon in the guidelines, only one method should be used, as use of more than one method will increase the incidence of double or non-taxation.

10. The main issue is the double or non-taxation of transactions where the general rule is broken. We believe that variations from the general principle that B2B services should be taxed in the country of the customer should be narrowly and clearly defined.

11. To minimise the inconsistency of treatment between countries, exceptions to the general principle need to be very clear. If double or non-taxation is to be avoided, consistency of treatment between the tax authorities of all parties to a transaction is essential.

12. From both a tax payable and administrative perspective additional costs in making recharges to branches should be kept to an absolute minimum.

13. These guidelines should be written to operate consistently with the other tax guidelines produced by the OECD, in particular the transfer pricing guidelines. If the transfer pricing guidelines operate effectively and costs end up in the country and company that uses them, then likewise the VAT will be incurred in the country and company of use.

14. If no recharge is being made for any other purposes, there should be no requirement to make a recharge solely for VAT. If transfer pricing operates correctly, there should be no need for such a recharge.

15. When employment costs are being recharged between branches with additions (eg accommodation or travel type expenses), we suggest that VAT should not be charged unless these additions exceed a de minimis limit for when recharges of external costs are subject to VAT. The de minimis limit should be determined, either as a percentage of the value of employment costs or as a list of 'associated costs' that are sufficiently closely connected to the employment costs.

16. The effects of VAT group registrations, cost sharing groups and similar entities, both domestic and international, need to be considered and included in these guidelines.

MAJOR POINTS

Supply of Services not in accordance with the general rule.

17. Consistency of treatment between tax authorities is essential to avoid double or non-taxation. The main issue is the double or non-taxation of transactions where the general rule is broken. Currently the guidelines give too much scope for individual tax authorities to depart from the general rule.

18. We believe that exceptions to the general rule should be narrowly targeted. All supplies should be taxed where received except for a small list of specific exclusions, such as services related to land.

19. There are various examples of double taxation that occur in practice that these guidelines as currently drafted do not address:

19.1. Cross border supply where local VAT is charged, as the end client is in the same country as that of an establishment of the supplier. This occurs even when the end client has to reverse charge VAT.
19.2. Cross border supply where local VAT is charged because there is a member of the corporate group in the same country as the customer, even though that company has nothing to do with the supply.
19.3. Local VAT charged, due to use and enjoyment rules, on software licences that are purchased as a cross border supply by a central purchasing function, and are invoiced back to the country of use as part of the corporate group's transfer pricing invoicing.

20. We agree that there is a need to carve out services that obviously fall outside the basic rule, such as land, travel costs and associated expenses. As we have noted in relation to Paragraph 3.101 below, we believe that the carve out from the general rule of services closely related to land should be very clearly and narrowly defined, perhaps by way of an appendix.

21. With restaurant, hotel, passenger transport and other similar services, it is often not known if the purchase is being made for business or personal purposes. To use the location of the restaurant, hotel etc. as the place of supply would therefore make the position clear. Again a clearly defined list should be provided to ensure clarity and that all countries treat items in the same way.

22. One area that we believe the guidelines do not address is the use and enjoyment rules, which currently result in double taxation. This is particularly an issue with multinational companies that have central procurement functions, which then recharge back to the country of use under transfer pricing guidelines. The cost ends up in the country of use, so applying VAT on the use and enjoyment of the software licence will result in VAT being charged on the initial supply to the central procurement function, and again when the transfer priced charge is received by the entity that uses the software licence. The guidelines should make it clear that use and enjoyment rules are unnecessary and should not be used.

23. We would welcome some discussion in these guidelines of alternative procedures that should apply relating to land, or the installation of fixed equipment on land, where the supplier is not established and is not registered for VAT in the country where the land is situated. If the customer is established and already registered for VAT in the country where the land is situated, the customer should account for reverse charge VAT rather than there being a requirement for the supplier to register in the country where the land is located.

Supply of Services by way of internal recharge

24. Our main concern with the proposals is their suggested treatment of recharges to branches. There are several instances where these proposals are unclear and leave unanswered questions, such as whether or not the reverse charge should only be applied to external costs and whether costs subsumed into other charges should be split out and full recovery be available in the entity which purchased them.

25. Additionally we do not think it is sufficiently clear that where externally purchased costs are purchased and are recharged within a multi-location entity (MLE), that full VAT recovery should occur in the country that recharges the costs. This is currently an issue where countries operate a simple partial exemption method, with a single rate of recovery, and do not allow full recovery of VAT where costs are recharged.

26. There is a concern that if international transfers within the same legal entity are treated as supplies for VAT purposes, there will be additional administrative burdens, costs and anomalies created.

27. For example, if a business has an overseas branch that employs staff who are paid by the head office in another country, the wages of the staff employed in the overseas branch would become subject to VAT in the country of the head office. The overseas branch would be deemed to be supplying services to the head office, with a value equivalent to the overseas wages being paid (plus any other costs incurred by the overseas branch). These supplies would become subject to the reverse charge in the country of the head office. If the business concerned was partially exempt, it would add a real cost to the business.

28. In effect, this creates the anomaly that the head office would be incurring VAT on the wages of its overseas employees, but not on the wages of employees in its own country. This could discourage businesses from setting up overseas branches. The same principle can also apply to overseas subsidiaries. This is illustrated by the example in Annex 2.

29. The diversion of the place of supply to any country where there has been no transaction should be avoided, and should be unnecessary given the operation of the OECD transfer pricing guidelines.

30. We understand that the intention is only to include in the recharge mechanism third party costs that are directly charged on (effectively pass-throughs) and not third party expenses that are then subsumed into some other group supply. Generally clarity is needed on what the recharge mechanism is intended to capture both in terms of internal and external cost components. Intra group transactions will not always be a straightforward model whereby head office enters into a global telecoms contract, for example, and then recharges out to the branches.

31. We are concerned that these guidelines do not address some of the complexities in modern corporate operations. In particular, there are a number of issues where it is not clear which is the purchasing entity for VAT purposes:

31.1. Contracts between one supplier and two customers within the same corporate group.
31.2. Contracts between one supplier and two customers from different corporate groups.
31.3. Issues where a corporate group customer wants to move the budget to a central purchasing entity, but does not want to change the contracting party due to duty of care and local control issues.
31.4. Contracts with more than one supplier.
31.5. Supplies involving VAT groups, cost sharing and similar groups.
31.6. Supplies involving joint ventures where no new distinct legal personality is formed, and supplies from the participating companies to the joint venture

32. Where it is not clear which is the purchasing entity for VAT purposes, the company and country paying for the services should be treated as the purchasing entity (unless payment is in a paymaster capacity on behalf of another company or country). Any initial anomalies created should be resolved by the correct operation of transfer pricing guidelines and the costs should end up in the company and country of use.

33. It is to be welcomed that the OECD is not looking at bringing the totality of intra-group charges within the scope of the proposal

Method for allocating taxing rights.

34. In the background to these guidelines the different methods of determining the place of taxation of supplies were discussed. We note that the guidelines have been written in accordance with the first method, the use of internal recharges. We support the use of this method, but as noted above only one method should be used because the use of more than one method increases the likelihood of double or non-taxation. With the correct operation of transfer pricing guidelines, even if there are multiple stages of supplies, the costs will end up in the correct country and company of use.

35. If it is decided that in some circumstances a direct use method should be used, we would like to see a clear definition of use. Rules should determine where consumption takes place if not in the country that contractually purchased the supply. It should be acknowledged that multinational entities often have central purchasing functions and that costs are recharged as part of corporate charges to the entity of use at a later stage. If transfer pricing operates correctly, the charge should end up in the correct location, unless the amount is trivial.

36. An economic assessment is required of the likely impacts on business of the proposals in these guidelines. In particular the impact on the financial services sector needs to be considered in detail.

COMMENTS ON SPECIFIC GUIDELINES AND BOXES

37. Guideline 3.1: we have no issues with this guideline, provided it is acknowledged that the route to the jurisdiction of consumption may involve a number of stages, but with the correct operation of transfer pricing guidelines, the costs will end up in the correct place.

38. Guideline 3.2: we agree with this guideline.

39. Guideline 3.3: we generally agree with this guideline. However, this can create practical issues where a local contract (within the same country) is entered into and the purchasing corporate group decides later to hold the budget centrally. Local VAT is still chargeable unless the contract is amended, but VAT is charged twice, on the initial purchase and on the later intra group charge required for transfer pricing purposes. Additionally, it is not clear if the contract is a tripartite agreement between the supplier, a company that receives and uses the services in the same country and the central purchasing entity of the corporate group that actually pays for the services and allocates the costs out using transfer pricing guidelines. These agreements are not uncommon, where a corporate group wants to operate a central purchasing entity, but also wants the local company to have control of the contract and the services provided. In cases where there could be more than one purchasing entity for VAT purposes, the taxing rights should accrue in the country from which the payment was made (assuming the payment was not made as paymaster) for consistency and clarity amongst all taxing authorities.

40. Box 3.1 Business Agreement: The definition is somewhat simplistic, as it only envisages one supplier and one customer, whereas there are often several parties to a business agreement. This complexity should be acknowledged and discussed in the guidelines, and guidance given to where the supply is received in a multipartite agreement. Our view is that the supply is received by the company making payment (in its own right, not as paymaster) for the services, as if this is not where the services are consumed, transfer pricing guidelines will ensure that it is invoiced to the country and company of use in due course.

41. Guideline 3.4: this is clarified by Guideline 3.5 and subject to our comments below, we agree with this guideline.

42. Guideline 3.5: we think it should be made clear that this guideline should only apply to actual recharges that already exist for other reasons, and that there should be no requirement to manufacture recharges purely for VAT purposes, as we believe that the application of transfer pricing guidelines will ensure the correct recharging, apart from trivial amounts.

43. Whilst the application of VAT to recharges within a MLE is contrary to current EU VAT law, we can understand that this will help eliminate double or no application of VAT. We are very concerned about the additional cost and complexity to businesses, especially as a significantly more formalised method of recharging will often be necessary, creating additional processes and documentation for businesses. Any guidelines must take into account their application, be capable of being applied in a simple and easy manner, such that their application is certain with all tax jurisdictions applying the guideline in a consistent manner. Above all, the position must be certain for taxpayers, so that normal commercial considerations apply to business decisions and VAT, or other tax considerations, are not in themselves a driver for business decisions.

44. Note 29: with the correct operation of transfer pricing guidelines, and the proposal to bring into the scope of VAT charges between establishments of a MLE, we consider use and enjoyment rules to be unnecessary, and their continued existence will create double taxation.

45. Paragraph 3.21: we consider the second sentence to be unnecessary, as transfer pricing guidelines will require a recharge, unless the amount is trivial, and if the amount is trivial, then any VAT issues will be trivial as well.

46. Paragraph 3.21 suggests that deemed supplies may be made in cases where there is no actual supply. We strongly argue that there should be no requirement to make a recharge for VAT purposes if no recharge is being made for any other tax purposes. This is most likely to be relevant with branch structures. The OECD transfer pricing guidelines ensure that costs are recharged and end up in the country and entity where they are used, unless the amount is trivial. Given this, the concept of additional recharges for VAT purposes seems superfluous, and creates an administrative burden for the entity for no real benefit.

47. Paragraph 3.23: this clarifies that the guideline does not deal with the VAT treatment of internally generated services, but does not clarify or refer to what the VAT treatment should be. This needs to be addressed so the position is clear. In our opinion internally generated services supplied within a MLE should be outside the scope of VAT, including externally purchased services either as defined such as accommodation, and other office services, or be subject to a de minimis limit.

48. Box 3.2: we think this is OK, apart from our comments regarding additional costs and burdens to business.

49. Note 31: we think this is superfluous in light of our comments above.

50. Paragraph 3.36: as detailed earlier, a supplier may have more than one customer under a contract, and this needs to be addressed.

51. Paragraph 3.48(iii) second bullet point: this is practically very difficult to track and administer in large multinational organisations, as this is normally agreed outside the finance area and the VAT issues are not understood to enable correct flow of information.

52. Paragraph 3.57: the detail as to which establishment enters into the contract needs to be the same for all countries to avoid double or non-taxation.

53. Paragraph 3.61: it should be made clear at the end of this paragraph that where an internal recharge is made, the location making the recharge should be entitled to a full VAT credit.

54. Paragraphs 3.67 through to 3.71 are in our view unnecessary. These guidelines should be read in conjunction with the transfer pricing guidelines that comprehensively deal with recharges and allocations of costs. These guidelines should simply be referenced to them.

55. Paragraph 3.72: we are concerned that this appears to require considerable documentation, above and beyond what is required for transfer pricing purposes.

56. Paragraph 3.79: This paragraph needs to be expanded to make the position clear. Is the internal recharge of staff costs outside the scope of VAT? Should a de minimis limit be applied to externally recharged costs? We are also concerned that this separation of costs will require considerable resources and additional costs to the business, which is why we believe that a de minimis limit or a defined list of services, such as accommodation and other office costs, should be allowed as a minimum.

57. Paragraph 3.84: we are firmly of the view that new methodologies and processes should not be required purely for VAT purposes.

58. Guideline 3.6: we agree with this guideline, but believe it needs to be very narrowly construed to ensure neither double or non-taxation, and a clear list of services that this covers should be detailed in an appendix. Leaving it to the tax authorities to determine will result in different tax treatment of the same items in different locations, and will lead to double or non-taxation.

59. Guideline 3.7: we agree with this guideline, but again believe it needs to be very narrowly construed, particularly regarding related supplies.

60. Paragraph 3.101 details the supplies relating to land that should be exceptions to the general rule. We believe the last bullet point should be written in such a way, possibly with a list in an appendix, as to narrowly define the services that have a very close, clear and obvious link with the immovable property. As this is currently written, if one tax authority takes a narrow view, and another tax authority takes a wide view, this will lead to double or non-taxation depending on the direction of the supply.

61. Paragraph 3.107: this paragraph needs to be expanded and clarified to ensure that all tax authorities treat costs in the same way. Allowing flexibility will result in double or non-taxation. A clear list of supplies is required.

62. Annex 2: The explanation relating to this annex is not sufficiently clear. Read one way, VAT recovery is allowed in full where costs are internally recharged. However, an alternative reading would be that VAT recovery would be limited to a residual partial exemption recovery. We believe that this needs to be clarified so that it can only be read that full recovery will occur for internal recharges, perhaps by making it clear that the allocation, and hence the knowledge of what will be recharged, occurs before the input VAT recovery.

63. Note 46 provides a description of stewardship expenses. The OECD should clarify the VAT treatment of these costs, particularly the recovery of input VAT, at some later stage in the development of these guidelines. In our opinion, any input VAT incurred relating to stewardship costs should be recoverable in full, as it relates to the active management of the corporate group.

64. This issue needs to be addressed in the context of cross border supplies. A domestic view is given, but it also affects which company will tax a supply when made cross border. There should be no attempts made to find stewardship costs when it is not obvious that they exist.

65. Note 48: it should be clarified when a paymaster function can create a separate supply.

E neil.gaskell@icaew.com

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)