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Subject: ***EBF Response to the OECD Consultation on the OECD International VAT/GST Guidelines***

Dear Mr Battiau, Beste Piet,

The European Banking Federation[1] (EBF) welcomes the opportunity to comment on the *OECD International VAT/GST Guidelines* and would also like to express sincere gratitude for your availability to meet giving us the opportunity to gain better understanding of the OECD work on the VAT field.

Please find below the EBF comments on the Guidelines under consultation.

We appreciate your consideration of our comments and remain at your entire disposal to elaborate further on our comments should you wish so.

Yours faithfully,

Hoogachtend,

Guido Ravoet

[1] Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU alone.

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EBF RESPONSE TO THE OECD CONSULTATION ON THE INTERNATIONAL VAT/GST GUIDELINES

GENERAL COMMENTS

- The EBF acknowledges the valuable role of the OECD to connect governments and businesses. Since this role is significantly more valuable when dealing with subjects such as VAT, where it is essential that all parties involved have a common understanding of the rules, EBF supports the initiative taken by OECD to develop the Guidelines to address uncertainty and risks of double taxation and unintended non-taxation that result from inconsistencies in the application of VAT to international trade.

- It is broadly accepted that the practical implementation of VAT exemptions and ability to reclaim input VAT varies between countries. It is therefore worth noting that in the context of neutrality, the Guidelines must aim to achieve a level playing field and avoid cascading tax. Additional clarity and certainty will help reduce both the administrative burden as well as complexity to the benefit of both tax authorities and business.

- Reference to 'final-users' often results in significant complexity for the financial services sector where this is taken to only include private individuals. For businesses engaging in exempt activities, VAT is a cost both in absolute (cash) terms and in terms of the resources required to administer the tax. Recognition within the guidance that entities engaged in exempt activity also constitute 'final-users' is vital to ensuring that the Guidelines are practical and workable for those businesses.

- We note that the Guidelines have been developed with a presumption that they are being applied to legitimate transactions and that anti-avoidance provisions are outside the scope of these Guidelines. However we would caution that the Guidelines will need to be reconsidered in light of the anti-avoidance proposals.

- Applying a VAT refund mechanism on the basis of reciprocal arrangements could undermine the principle of neutrality and is not supported by business. Therefore, the EBF takes the view that reciprocity should not play a part in a neutral VAT/GST system.

- Since the final Guidelines will include principles that should be followed by OECD members to ensure a smooth interaction between national VAT systems, we raise concerns over some aspects of the Guidelines where multiple options are suggested as a potential approach of OECD members to follow. We consider this aspect may lead to the development of an inconsistent approach to the application of the Guidelines. Financial institutions and other business desire certainty in their dealings and providing for multiple treatments, risking double taxation and thus undermining the purpose of the Guidelines.

- The EBF would caution that the Guidelines lose value if regional bodies such as the EU were not to adopt them as this would create a conflict in the application of the Guidelines by OECD members who are also members of the EU. In this context, we note the parallel work being carried out by the Commission towards a new EU VAT system and the need to avoid that both may start diverging from each other at one point in time.

CHAPTER 2

NEUTRALITY OF VALUE ADDED TAXES IN THE CONTEXT OF CROSS-BORDER TRADE

The EBF would like to provide few comments in Chapter 2 of the consultation about VAT neutrality. While we acknowledge this particular part is not under consultation, EBF wants to stress the importance to recognize that for the financial industry VAT is one of the heaviest tax levies to be charged despite the fact that VAT is a tax on the final consumption of goods and services and not on the businesses.

The EBF considers it must be stressed that the possibility for banks to compete on a level playing field among together or with other players in the financial sector who are not exempt is even more important today in a globalized world with high-tech IT solutions. We therefore strongly believe that – given that the general exemption for financial services were to be kept – there is a need for changes in the current VAT framework in order for banks and others to be able to decrease the costs they have for irrecoverable VAT today.

The EBF believes the current situation could be improved if there was a general possibility to opt for taxation or that financial services were zero-rated. An option to tax would unblock VAT expenses currently blocked within the transaction trail.

Zero-rating the supply of financial services to other taxable persons would in the same way solve the problem of non-deductible VAT for the economic sector concerned. It would also give the financial sector the possibility to make full use of the possibilities of increasing their competitiveness thru, for example outsourcing and pooling.

Making cross-border VAT-grouping mandatory as well as clarifying and elaborating the current rules for cost-sharing arrangements are two other options which would make the situation for the financial sector more similar to that of non-exempt businesses.

Having said that, EBF welcomes all efforts of the OECD to increase the VAT neutrality for the financial industry.

BASIC NEUTRALITY PRINCIPLES & NEUTRALITY IN INTERNATIONAL TRADE

Having carefully analyzed the OECD document, the EBF identifies inconsistency among Guidelines within this section and with text within the document. We, for example, consider that by comparing Guideline 2.1 with the overarching principles as set out in section 1.2 (Chapter 1), one can reach the view that the basic principles of neutrality have failed. Although we read section 2.4 tries to clarify this point, Guideline 2.2 appears to apply at the immediate transactions and not to the overall neutrality of the tax.

For a better understanding of our concern, the following example aims to explain the lack of neutrality in respect of the overarching principle (Section 1.2) and Guideline 2.1:

For a business part of the financial services sector within the EU e.g. UK, this business under Guideline 2.1 will face the burden of VAT as if it were a consumer. While a US financial sector business would for example be treated as also facing the burden, this one is rather theoretical due to the non existence of a VAT system in the US. However, when it comes to making supplies/providing services (assuming that the services are the same from the UK and US businesses) to a customer within the EU e.g. France, and the service qualifies for exemption, Guideline 2.2 will dictate that both sets will be exempt. Both will thus be taxed at a similar level.

Further in this point, we consider Guideline 2.3 contradicts Guideline 2.1 since the latter could potentially make a business in financial services situate itself outside a VAT system to gain a commercial advantage by not having the burden of VAT on costs. We thus consider the Guidelines appear to mistakenly take for granted that everyone signing up to them has a VAT system. As a final point in this matter, the explanation following Guideline 2.4 makes reference about not disadvantaging foreign businesses rather than addressing the immediate lack of neutrality created by Guideline 2.1.

CHAPTER 3

BUSINESS AGREEMENT

Business agreements are defined as agreements concluded between separate legal entities of the same company or external parties. As described in section 3.9 of the Guidelines, the proxy for the Main Rule to determine the customer's identity in a business-to-business supply is based on business agreements. Since the term business agreement is also used in a more general sense, the local tax administrations would have to provide some clear guidelines on which kind of business agreements are sufficient for the customer's identification and thus may serve as validation to determine the place of taxation.

The EBF considers a clear guidance will not only lower the cost for the tax compliance and administration for the tax payer and the tax authority but also increase the clarity and certainty on which business agreements are relevant in this context.

In another context, we draw attention to the fact that a non written business agreement (section 3.13) would probably lead to discussions with the local tax administrations and could easily be challenged.

RECHARGE METHOD

The EBF agrees with the principle that the place of consumption of external services received by Multiple Location Entries (MLEs) should be the place of the establishments that really use and enjoy the services. Nevertheless, EBF has some concerns about the methodology proposed by OECD in order to allocate the services to the establishments.

The FCE Bank case[2] says that a fixed establishment, which is not a legal entity distinct from the company of which it forms part, established in another Member State and to which the company supplies services, should not be treated as a taxable person by reason of the costs imputed to it in respect of those supplies. For the Court of Justice of the European Union (CJEU), the services supplied in the case at hand are out of scope of VAT as it is impossible for a single legal person to supply services to itself.

The OECD Guidelines breaches this principle when submitting to VAT the recharge arrangements between MLE's. Even if the OECD agrees explicitly that the recharge method applies only to external services received by the MLEs, EBF considers that it will be very difficult to dissociate external and internal costs without using very complex activity based costing systems.

The EBF notes the potential risk of the recharge method is that the local tax administrations will ask that the taxpayer prove the distinction they make between recharges of external versus internal costs and that all recharges would be taxed if the distinction cannot be sufficiently demonstrated. We consider this distinction will be extremely complex to make when complex services are to be

[2] European Union Court of Justice case C-210/04

supplied e.g. if an establishment uses IT hardware plus external consultants plus internal staff in order to provide a full IT service to the other establishments of a MLE.

In this context, the EBF proposes that the Guidelines explicitly confirm that only external costs recharged as such (i.e. without addition of any internal services which would transform - even slightly - these external services) should be subject to the recharge arrangement mechanism.

For the mixed or exempt VAT taxpayers, the recharge arrangements will be VAT neutral only if the recharging entity has a full right of deduction of the VAT on the recharged inputs. For these particular cases, the EBF proposes that the Guidelines explicitly mention that a full deduction of VAT based on the actual use of goods and services should always be guaranteed by the tax authorities in case of recharge arrangements.

INTERNALLY GENERATED SERVICES

The EBF acknowledges the Guidelines do not deal with internally generated or developed services as mentioned in section 3.23, which are therefore not considered with respect to the recharge method. However, taxpayers as consequence do not know how to treat the charges of internally generated services with respect to other establishments. Should such internally generated services be treated differently in a VAT perspective than the recharges of externally purchased services within MLEs e.g. out of scope of the VAT, the taxpayer would need an advanced recharge system to separate the externally purchased services, which shall be recharged to the appropriate MLEs, and then taxed at the location of the MLEs from the internally developed services which are e.g. not to be taxed.

Since this scenario certainly creates a higher administrative burden for the business which leads to higher cost to implement such a recharge system, we strongly consider a clarification of this issue in the Guidelines would be highly recommended.

ANNEXES

The EBF welcomes the inclusion of the additional information contained within the Annexes but believe these could be made more user-friendly. Some of the examples were also seen to be too business subjective e.g. by reference to how a business may implement Enterprise Resource Planning (ERP) systems, and therefore perhaps not the best way to demonstrate how these principles should be applied.

The EBF would suggest that the annex includes explicit reference that Example 2 in Annex 1 is equally applicable to MLEs. This could be expanded to include a specific MLE example or included as part of Annex 2.

The EBF notes that the final paragraph on page 54 may create confusion between the provision of services and the performance of activities in the course of providing those services. In particular it would be helpful to clarify the last sentence that reads "The fact that services are *supplied to* someone... different from those to … which the services are directly provided is not relevant in this example ….".

It would be preferable to make clearer the distinction between "supplied to" (determining the relationships for VAT) and 'provided to' (being more about the underlying performance).

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