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VAT rules for financial and insurance services today and tomorrow

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Introduction

Objective

The objective of this public consultation is to obtain the views of stakeholders and public authorities of the Member States on the current VAT rules for financial and insurance services and their functioning as well as on possible changes to these rules. The answers provided will feed into the review of the relevant provisions of the VAT Directive and will contribute to a possible future legislative proposal.

Context

The current VAT rules for financial and insurance services are criticised for being **complex**, **difficult to apply** and for **not having kept pace with the developments of new products and services**. This seems to have led to a lack of **VAT neutrality**, **legal uncertainty** and **high administrative and regulatory costs**.

VAT is a tax levied on the consumption of goods and services within the European Union. It is a multi-stage tax calculated, and thus charged, on each stage of the value chain. Operating businesses pay the VAT due on their supplies at regular intervals. This is the VAT due on their outputs – the output VAT – after deducting the VAT on their inputs – the input VAT. The system of deduction ensures that the tax is neutral, with respect to the length of the supply chain and the number of transactions therein. However, where the output supply is exceptionally not taxed because it is exempt or out of the scope of the application of VAT, the right to deduct does not hold.

Main issues under the current rules

However, under the current rules, financial and insurance services constitute an exception to these principles: as listed in Article 135(1)(a)-(g) of the VAT Directive, most of them are exempt from VAT. The reasons behind the introduction of the exemption are multiple, but mostly related to the technical difficulty to calculate the tax amount. However, these rules were introduced in 1977 and have since become outdated.

Because of the exemption, the providers of financial and insurance services **cannot deduct the VAT incurred on inputs**, notably – but not exclusively – on investment goods, that are used to produce exempt outputs. This deprives the tax of its neutrality: unlike for other businesses, who can deduct it, VAT becomes a cost for providers of financial and insurance services, and, eventually, for their customers (as the so-called ‘hidden VAT’).

To address the problem of hidden VAT, the VAT Directive provides for a number of structural provisions:

- **The option to tax** allows providers of financial services to charge VAT on certain otherwise exempt services, and thus to increase the proportion of taxed turnover and the corresponding input deduction. It is, however, up to Member States to introduce such an option and it is not available to insurance service providers.
- More commonly, financial and insurance service providers make use of two other existing instruments to minimise irrecoverable (hidden) VAT: **VAT groups** and – until recently – **cost-sharing arrangements**.

Since financial and insurance service providers are usually part of large company groups or other networks, these two instruments, albeit being different from a legal perspective, allow them to centralise at group level common business functions (e.g. IT services, accountancy, regulatory compliance, back office support, tax advisory) without generating irrecoverable input VAT on intra-group charges. However, on the one hand, the Court of Justice of the European Union (CJEU) in 2017 found cost-sharing arrangements used by financial and insurance operators inadmissible (see judgements 1, 2 and 3). On the other hand, the VAT grouping scheme is limited exclusively to operators established in the same Member State and is implemented (if at all) in various ways across the EU. This raises the question of how to address the problem of hidden VAT in this important economic sector.

Apart from the implications of this recent case law, the VAT treatment of financial and insurance services raises other problems. The current rules are believed to be **complex** and **difficult to apply in practice**, and possibly **have not kept pace with the developments of new services** in the financial industry (for example services linked to crypto-assets and e-money). This seems to have led to **increasing litigation before the CJEU**, **legal uncertainty** and **high administrative and regulatory costs**. Moreover, such rules are interpreted and applied inconsistently by Member States, which contributes to **distortions** within the EU and in exchanges with third countries.

The Commission proposed to review the rules on the VAT treatment of financial and insurance services already in 2007 through a legislative package that comprised a proposal for a Council Directive and a proposal for a Council Implementing Regulation. However, the discussions in the Council came to a standstill and the proposals were withdrawn in 2016.

Against this background, as announced in the Communication on an Action Plan for fair and simple taxation supporting the recovery strategy, the Commission is currently preparing a proposal to review the VAT rules for financial and insurance services. This initiative is part of the objective to simplify the life of taxpayers operating in the Single Market, one of the priorities laid down in the Political Guidelines for the present Commission.

Glossary

Terms used in this context:

- **Taxable amount**: the amount in respect of a taxable transaction upon which VAT is chargeable.
- **Output VAT**: the VAT due on taxable persons' supplies' or outputs.

- **Input VAT**: the VAT paid by taxable persons for supplies made to them with regard to their business activity.
- **Hidden VAT**: a consequence of the exemption; input VAT becomes irrecoverable and increases costs for service providers while being invisible to customers as not invoiced as such to them.
- **VAT neutrality**: one of the most important principles of the VAT system, ensuring that the VAT due by the final consumer is the same, regardless of the nature or length of the supply chain for producing it; VAT is collected fractionally via a system of partial payments whereby at each stage of the supply chain, the taxable person deducts input VAT paid from the output VAT collected.
- **Option to tax** under Article 137(1)(a) of the VAT Directive: an optional regime allowing financial service providers to consider otherwise exempt supplies as taxed.
- **VAT grouping** under Article 11 of the VAT Directive: a simplification measure that allows, if introduced by the Member State, groups of 'legally independent' persons 'closely bound to one another by financial, economic, and organisational links' to be treated as a single taxable person. Consequently, intra-group transactions become, from a VAT perspective, "intra-company" supplies and thus fall outside the scope of the tax and do not result in irrecoverable input VAT.
- **Cost-sharing arrangements** under Article 132(1)(f) of the VAT Directive: an exemption allowing amongst others providers of certain exempt services to form 'independent groups', to pool the acquisition of input supplies and re-distribute the costs, from the group to its members.
- **Proportional (pro rata) deduction** based on Article 173 et sec. of the VAT Directive: Member States may apply different methods to determine the input VAT that can be deducted in the case of a taxable person supplying taxed, exempt and out-of-scope services.
- **Fee-based taxation**: a method of calculation of the taxable amount based on the remuneration linked to financial and insurance services.

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*1 Language of my contribution

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- Other

*3 First name

Fredrik

*4 Surname

Bonthron

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fredrik@svpm.se

*9 Organisation name

255 character(s) maximum

Swedish Securities Markets Association

* 10 Organisation size

- (x) Micro (1 to 9 employees)
- ( ) Small (10 to 49 employees)
- ( ) Medium (50 to 249 employees)
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Your experience with the current rules

20 The exemption of financial and insurance services from VAT was introduced in 1977 as an exception to the general rule that VAT is to be levied on all services supplied for consideration by a taxable person. To what extent do you agree that the exemption is still needed?

- ( ) Strongly agree
- (•) Agree
- ( ) Neutral
- ( ) Disagree
- ( ) Strongly disagree
- ( ) Not sure

21 In general, how would you assess the functioning of the exemption of financial and insurance services?
The exemption...

- ( ) ... works very well
- ( ) ... works well, but could be improved
- (•) ... works poorly and should be improved
- ( ) … should be removed
- ( ) No opinion

22 Please indicate the reason(s) why.
The exemption...

Multiple answers possible

- [x] ... is too costly to apply
- [x] ... is too complex in terms of notions (structural provisions and the definition of exempted services)
- [x] … is not clear in terms of notions (structural provisions and the definition of exempted services)
- [x] ... may have a distortive effect on competition with businesses in other Member States
- [x] Other
- [ ] No opinion

23 Please indicate which other reason(s).

The exemption is costly to apply in terms of risks that the exemption is not at hand and who will bear the risk for that cost in business arrangements such as outsourcing and partnerships. Furthermore, costs related to assessments that need to be performed (time spent or consultancy costs). The uncertainty also leads to significant amount of advance rulings and in case of an audit, appeals to the court. Due to the lengthy processes the issues remain open for years which create even more costs and uncertainty relating to the VAT treatment. It should not be the case that the only option to get certainty is to go through a process that takes typically 2 to 5 years (or the worst even 9 years).

24 How do you estimate the impact of the lack of input tax deduction and hidden VAT?

Multiple answers possible

- [x] They create a price barrier to outsourcing
- [x] They undermine the level playing field between providers of outsourced services and in-house providers
- [x] They affect the business structures of those operating in the financial and insurance sector
- [x] They increase the costs for business customers
- [x] They increase compliance costs
- [x] They undermine the competitiveness of the sector
- [ ] Other
- [ ] Do not know

26 The compliance with VAT rules can be more difficult when supplying financial and/or insurance services cross-border. How do the factors listed below contribute to that effect?

	Not at all	Somewhat	To a large extent	No opinion
Difficulty of finding information on VAT obligations in other Member States	○	●	○	○
Different interpretations on definitions of exempted services	○	○	●	○
Different rules for opting to tax	○	●	○	○
Availability of VAT grouping	○	●	○	○
Availability of cost-sharing arrangements	○	●	○	○
Different deduction methods	○	○	●	○
Different VAT obligations in other Member States	○	●	○	○

Other	◯	◯	◯	◯

28 Do you think that the current rules hinder the development of cross-border supplies of financial and insurance services?

- [x] Yes
- [ ] No
- [ ] Do not know

29 Please indicate the reason(s) why.

Multiple answers possible

- [ ] Regulatory ecosystem too complex
- [x] VAT rules for financial and insurance services too complex
- [x] Discrepancies across VAT treatment by Member States
- [ ] Other

34 The exemption was put in place i.a. due to the technical difficulty to calculate the taxable amount. To what extent do you agree that progress in technology, enhanced transparency rules and experiences gained from other countries and from other indirect taxes could help overcome this issue?

- [ ] Strongly agree
- [ ] Agree
- [ ] Neutral
- [x] Disagree
- [ ] Strongly disagree
- [ ] Do not know

35 Do the current VAT rules for financial and insurance services result in prices lower than those that would apply if these services were taxed?

- [ ] Yes, but just for final non-taxable customers
- [ ] Yes, for all customers
- [ ] In part, due to other similar taxes
- [ ] No
- [x] Do not know

36 To what extent are the current structural provisions effective in increasing the deduction of input tax and reducing the impact of hidden VAT?

	Not effective at all	Somewhat ineffective	Neither effective nor ineffective	Somewhat effective	Very effective	No opinion
Option to tax	○	○	○	○	○	●
VAT grouping	○	○	○	○	●	○
Cost-sharing arrangements	○	○	○	○	●	○
Proportional deduction	○	○	○	●	○	○

37 VAT provisions related to financial and insurance services can be perceived as complex. For which of the current structural provisions is that correct?

Multiple answers possible

- [x] Option to tax
- [x] VAT grouping
- [x] Cost-sharing arrangements
- [x] Proportional deduction
- [ ] None

38 To what extent do you agree or disagree with the following statement: The lack of input tax deduction is detrimental to the financial and insurance sector. It compels the sector to outsource services which are typically provided in-house, thus raising the costs.

- ( ) Strongly agree
- ( ) Agree
- ( ) Neutral
- ( ) Disagree
- ( ) Strongly disagree
- (•) Do not know

40 To what extent do you agree that the current VAT rules are fit to cover emerging trends in the industry (such as digitalisation)?

- ( ) Strongly agree
- ( ) Agree
- ( ) Neutral
- ( ) Disagree
- (•) Strongly disagree
- ( ) Do not know

41 The VAT treatment of emerging trends under the current VAT rules for financial and insurance services can be problematic due to unclear definitions for VAT purposes. In connection with which of the emerging trends listed, do you consider this correct?

Multiple answers possible

- [x] Services provided by means of fintech
- [ ] E-money

- [x] Services linked to crypto-assets (such as mining)
- [x] Payment services
- [x] Other
- [ ] Do not consider it problematic
- [ ] Do not know

42 Please indicate which other trend(s).

> Regulatory rules e.g. MIFID II and PSD II, constitutes new value chains with more legal entities involved in the supply of services. These legislative changes have given rise to legal uncertainty in the VAT area in almost all EU-countries and have had an impact on the VAT-treatment within the industry. The distinction between a Payment Service Provider and a Fintech company and what this entails for the deduction of input VAT, CESOP reporting etc. are one of many examples. Another is the need to unbundle services from a MIFID II perspective. If a review of the exemption is performed it is important that the legislator extends the analysis and follow the development in the industry, so that the new rules are adequate for the market and industry as a whole and ensures that it does not distort competition.

43 The regulatory framework in the financial and insurance sector (e.g. the Markets in Financial Instruments Directive (MIFID) and the Insurance Distribution Directive (IDD)) has strengthen the role of intermediaries. Do you consider the VAT exemption to be coherent with this development?

- ( ) Yes
- (•) No
- ( ) Do not know

Possible changes to the current rules

The Commission is intending to prepare a proposal that will seek to modernise the current VAT rules for financial and insurance services. Your answers will feed into the review of these rules.

44 In your view, which would be the best way to reform the rules on exemption?

Multiple answers possible

- [x] Update definitions of exempt services drawing on the extensive CJEU case law in the field of VAT
- [x] As regards the definitions, refer to other EU regulations governing the financial and insurance sector
- [ ] Removing the exemption, so that definitions will be no longer needed
- [x] Other
- [ ] Do not know

45 Please indicate which other way(s).

The member states implementation of the directive and the definitions need to be aligned, considering ECJ case law. Much could be done short term to fix some of the problems e.g., created by ECJ rulings on VAT groups and CSAs. A proposal where the VAT exemption is not removed but made more aligned between the Member States would have a positive effect on the competition with businesses in other Member States. There should be no questions on how certain financial services (when looking at the nature of the service) are treated for VAT purposes. Adjusting Article 135 of the VAT Directive with the principles laid down by ECJ case law would improve the alignment of interpretations between the Member State. In the long term, the removal of the exemption should be further investigated

46 The removal of the exemption for financial and insurance services could benefit the neutrality of the VAT system. What could be other effects of such a removal?

Multiple answers possible

- [x] Simplification in the application of the VAT rules for financial and insurance services
- [ ] Lower VAT compliance costs
- [x] Less distortive effect of the exemption on competition linked to suppliers from non-EU countries operating in the EU
- [x] Higher VAT compliance costs
- [x] Higher complexity of VAT rules
- [ ] None
- [x] Other

47 Please indicate which other effect(s).

- Removal of the VAT exemption would not only decrease VAT compliance. It would also increase compliance, as more invoices must be issued. Furthermore, it is our understanding that there would still be VAT exemption on e.g. mortgages, meaning that the compliance in calculating the VAT recovery pro rata etc, making VAT assessments etc. will still be applicable. The same applies if only fee-based exemptions were to be removed.

- Final costs for the FS sector depend on how the exemption is removed, cf. standard rate, and no other adjustments of adjacent taxes such as insurance premium tax, payroll duties, and similar.

- The removal would lead to substantial IT development costs and might result in higher costs for customers.

48 If only fee-based financial services were to be taxed, in relation to which of them would it be difficult to determine the taxable amount?
Please explain.

- Definition of fee – especially relating to loan products – is not clear. Is the monthly fee to confirm that the interest rate is below agreed percentage a fee or part of the interest paid? If you can select a product with a higher fee at the beginning of the loan period with a lower interest rate or a lower fee with higher interest rate – are they the same product? And what about any fee that is paid if you want to pay the loan with fixed interest rate in advance – that is determined based on the interest that would be paid during the loan period – is that a fee or part of the interest (or compensation for damages)? If only the fee-based products would be subject to VAT, the definition of a fee-based product must be clear.

- Most of the fees are such that no invoice/receipt is currently sent out to the client (fee relating to bank account, withdrawal of money, transfer of shares etc.) – these are mentioned in the (electronic) account statement or similar. The amount of receipts and invoices needed would increase dramatically.

- If the plans to introduce real-time reporting of invoice and receipt data would materialise, this would exponentially increase the amount of data that is needed for reporting.

49 Financial service providers may currently opt for taxation and obtain the right of deduction, but it is up to each Member State to introduce such option. Should Member States keep that discretion?

- ○ Yes
- ● No, it should be available in all Member States
- ○ No opinion

50 Not having a right of deduction when supplying exempt financial and insurance services impairs the neutrality of VAT. To what extent would you support or oppose the introduction of a fixed rate of input tax deduction to remedy that effect?

- ○ Strongly support
- ○ Support
- ○ Oppose
- ○ Strongly oppose
- ○ No opinion

51 If a fixed rate of input tax deduction was introduced, should such a rule remain optional for operators or, alternatively, should it be mandatory?

- ● It should be optional
- ○ It should be mandatory
- ○ No opinion

52 Should cost-sharing agreements be made available to the financial and insurance services sector?

- ● Yes

- [ ] No
- [ ] No opinion

53 In your view, should businesses established in other Member States be allowed to form part of the cost sharing arrangements?

- [x] Yes
- [ ] No
- [ ] No opinion

54 Please indicate the reason(s) why.

Multiple answers possible

- [x] To achieve a more level playing field for businesses
- [x] To boost competitiveness of financial and insurance service providers
- [x] To reduce the tax burden and the administrative costs of businesses operating at cross-border level
- [x] Other

55 Please indicate which other reason(s).

The lack of cross border CSA or VAT group increases VAT cost for entities operating cross border compared to those operating only in one member state. This is a trade barrier hindering the free movement of services and capital.

CSAs should be introduced at least for branches of an entity and companies in a same group, preferably also between independent parties cross border. Availability of CSAs would reduce the need to take potential VAT costs into account when deciding how to structure the business and, if available between independent parties, increase outsourcing possibilities. VAT neutrality and economic efficiency will improve. CSA should be possible to use when there is a mark-up because of Transfer Pricing or Income tax regulations (as those regulations in general do not allow pricing based on self-cost).

58 Which is the most beneficial aspect of establishing VAT groups for providers of financial and insurance services?

	Not beneficial at all	Somewhat detrimental	Neither beneficial not detrimental	Somewhat beneficial	Very beneficial	No opinion
It is optional			(selected)			
Intragroup supplies are out of scope and therefore not taxed					(selected)	
VAT compliance costs are lower for the members of the group as they are pooling them					(selected)	
It is easier to outsource the activity through a single taxable person			(selected)			
VAT grouping increases the competitiveness of the sector by reducing hidden VAT					(selected)	
Other	(selected)					

59 Please indicate which other aspect(s).

VAT grouping results in cross-border supplies of services to branches of the same legal entity being subject to VAT, cf. ECJ on Danske Bank, the Skandia case etc. This limits the use of either VAT Grouping or cross-border structures. VAT grouping must remain optional.

60 Which is the most effective way to reform the rules for financial and insurance services in your country?

	Not effective at all	Somewhat ineffective	Neither effective nor ineffective	Somewhat effective	Very effective	No opinion
Remove the exemption and tax financial and insurance services at a standard rate	◉	○	○	○	○	○
Remove the exemption and tax financial and insurance services at a reduced rate	◉	○	○	○	○	○
Tax only fee-based services at a standard rate	◉	○	○	○	○	○
Tax only fee-based services at a reduced rate	◉	○	○	○	○	○
Grant businesses the option to apply VAT	○	○	○	○	○	◉
Grant businesses the right to constitute a VAT group in every Member State	○	○	○	○	○	◉
Make cost-sharing arrangements available to the sector in all Member States	○	○	○	○	◉	○
Other	○	○	○	○	○	○

Where financial and insurance services are taxed, deduction of input VAT is possible.

Further comments

62 If you wish to add further information within the scope of this questionnaire, please feel free to do so here.

2000 character(s) maximum

See attached file for additional comments. In or view the main problem with the current legislation is that it is old and not harmonized between the member states. We would like to keep the exemption but wish for more clarity and harmonization throughout EU and different parts of the industry (such as the old school bank sector and the fintech industry to achieve a fair competitive market). One way going forward is the envisaged review were we hope for and updated and clarification of different parts of the legislation another could be the current proposal to give the VAT Committee extended authority to issue binding guidelines in respect to interpretation of the EU directive and case law.

63 If you wish to upload a concise document, please do so below. The maximal file size is 1MB.

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Please note that the uploaded document will be published alongside your response to the questionnaire, which is the essential input to this open consultation. The document is an optional complement and serves as additional background to better understand your position.

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