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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 However, these rules were introduced in 1977 and have since become outdated.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.

About you

* 1 Language of my contribution

- ○ Bulgarian
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- Non-governmental organisation (NGO)
- Public authority
- Trade union
- Other

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*9 Organisation name

255 character(s) maximum

European Association of Paritarian Institutions (AEIP)

* 10 Organisation size

- (selected) Micro (1 to 9 employees)
- Small (10 to 49 employees)
- Medium (50 to 249 employees)
- Large (250 or more)

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Check if your organisation is on the transparency register. It's a voluntary database for organisations seeking to influence EU decision-making.

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- Croatia
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- ○ **Anonymous**
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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
- (x) 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
- (x) ... works poorly and should be improved
- ( ) … should be removed
- ( ) No opinion

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

Multiple answers possible

- [ ] ... 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)
- [ ] ... 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 from VAT triggers wages tax in France and the taxation ratio used for wages tax purposes is linked to the VAT recovery ratio of French taxpayers. Should insurance activities become VAT taxable, absent a modification of the legal provisions currently applicable, most French-based insurers would not be liable anymore for French wages tax. In addition, due to their VAT exemption, insurance premiums are subject to specific taxes (insurance premium taxes). At this stage, it is unclear whether the French authorities would amend the scope of (i) the French wages tax and (ii) existing taxes based on insurance premiums to maintain these taxes notwithstanding the end of the VAT exemption of insurance related activities.

The definition of insurance related services rendered by intermediaries and brokers becomes more and more complex and, without VAT exemption, cost-sharing between unrelated legal entities generate hidden VAT which cannot be absorbed only with the VAT grouping regime set by article 11 of the VAT Directive.

Lastly, French provident funds are managed by dedicated entities (notably “Provident institutions”) which are statutorily also involved in VAT exempt activities of general interest. The fact that their insurance and providence activities would become taxable whereas their activities of general interest would remain exempt from VAT would create issues that could lead to sound modifications in the structuring of the groups to which these entities belong.

In particular with regard to Institutions of Occupational Retirement Provision (IORPs), we strongly believe that the exemption is still needed because a repeal of the exemption risks would lead -yet again- to a cost increase for IORPs and their members, given the fact that the former are unable to recover the VAT on purchases of services or goods. This rise of expenditures will either have to be financed by the sponsor, or be borne by the members so neither of these scenarios will result to a positive outcome. Sponsors are already confronted with historically low interest rates and face very challenging times given the economic uncertainties in the wake of the COVID-19 crisis. Additional costs borne by members will lead to a decline in the adequacy of their pensions, against the current backdrop of (e.g.) the Capital Markets Union Action Plan where Member States are called upon to create a Pension dashboard to facilitate the monitoring of pension adequacy. Thus, AEIP is in favor of extending the current exemption for special investment funds to all pension schemes, meaning that these should be treated equally for VAT purposes, irrespective of the Member States in which the management services are rendered.

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
- [ ] They undermine the level playing field between providers of outsourced services and in-house providers
- [ ] They affect the business structures of those operating in the financial and insurance sector
- [ ] They increase the costs for business customers
- [ ] They increase compliance costs
- [x] They undermine the competitiveness of the sector

- [x] Other
- [ ] Do not know

25 Please indicate which other reason(s).

The absence of VAT exempt cost-sharing structures between entities belonging to distinct groups of companies may prevent actors to mutualize the costs incurred to achieve the joint treatment of their respective portfolios in the event that a common structure can be implemented to do so with a limited cost (e.g., setting up of the data transmission system between insurers and the French Treasury for income tax purposes).

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	○	○	○	●

27 Please indicate which other factor(s).

The limited extent of the French insurers’ VAT recovery rights makes the self-assessment of VAT according to the reverse charge mechanism a costly process, which generates almost exclusively hidden VAT.

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

- (●) 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
- [x] Other

30 Please indicate which other reason(s).

As outlined by the Commission, the VAT grouping regime as well as the VAT-exempt cost-sharing structures may differ from one Member State to another. In addition, the election for VAT taxation in one EU member state is not always recognized abroad, which creates difficulties when computing the amount of recoverable VAT.

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
- ( ) 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
- (•) 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)
- [ ] Payment services
- [x] Other
- [ ] Do not consider it problematic
- [ ] Do not know

42 Please indicate which other trend(s).

> The definition of insurance and insurance-related services becomes more and more complex, due to ECJ case-law decision. Therefore, any dismembering of an insurance operation, for instance for sub-contracting purposes, is likely to be subject to VAT. This will notably be the case of any insurance portfolio management activities.

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
- [ ] Other
- [ ] Do not know

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
- [ ] Higher VAT compliance costs
- [ ] Higher complexity of VAT rules
- [ ] None
- [x] Other

47 Please indicate which other effect(s).

> Exemption from French wages tax. As outlined above, the VAT exemption of French taxpayers triggers their liability for French wages-tax as well as insurance premium taxes ("IPT"). Therefore, to be in position to accurately measure the impact of the VAT taxation of financial services and, in particular, of insurance activities, the impact of this VAT taxation on the French wages tax and IPT liability of insurers and other actors of the financial sector should be confirmed.

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.

> The notion of VAT taxable fee-based financial services should be clarified.

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?

- (x) 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?

- (x) 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?

- ( ) Yes
- (x) No
- ( ) No opinion

56 Please indicate the reason(s) why.

Multiple answers possible

- [ ] To open up the cost sharing arrangements exemption cross border would negatively affect the revenues of Member States having introduced the exemption
- [x] Because cost sharing arrangements mostly operate in the national market of their own Member State
- [x] To open up the cost sharing arrangements exemption may encourage cross-border operations and establishments in Member States whose tax administration are more flexible and, consequently, increase the competition between Member States
- [ ] To open up the cost sharing arrangements exemption would increase administrative costs for stakeholders and Member States' tax administration, derived from increased controls and audits
- [x] Other

57 Please indicate which other reason(s).

As a general manner, VAT exempt cost sharing arrangements constitute the only mean to exempt from the mutualization of costs between unrelated entities belonging to distinct groups.
In addition, as mentioned above, provident institutions of social protection are involved both in VAT exempt insurance activities and in activities of general interest, generally out of the scope of VAT. In such cases, the use of VAT cost sharing arrangements enables to share costs benefiting to both sectors.

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	○	○	○	●	○	○
Intragroup supplies are out of scope and therefore not taxed	○	○	○	○	●	○
VAT compliance costs are lower for the members of the group as they are pooling them	○	○	○	●	○	○
It is easier to outsource the activity through a single taxable person	○	○	○	○	●	○
VAT grouping increases the competitiveness of the sector by reducing hidden VAT	○	○	○	●	○	○
Other	○	○	○	○	○	○

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

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

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