

Value added tax VAT: common system, treatment of insurance and financial services

2007/0267(CNS) - 28/11/2007 - Legislative proposal

PURPOSE: to amend Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services.

PROPOSED ACT: Council Directive.

CONTENT: the Commission states that the definitions of exempt insurance and financial services in this Directive are out of date and have led to an uneven interpretation and application of these exemptions by Member States. Stakeholders are confronted with considerable legal complexity and varying administrative practices generating legal uncertainty for economic operators and fiscal authorities. This legal uncertainty has led to an increasing number of court cases and increased the administrative charges of operators and administrations for applying these exemptions. It is therefore necessary to clarify the rules governing the exemption from VAT for insurance and financial services with the aim of creating more legal certainty and reducing administrative charges for operators and administrations.

A second problem is that of hidden VAT in the cost structure of insurance and financial services. In financial services and insurance services all economic operators are striving to improve their competitiveness since they are increasingly exposed to competition both between themselves on account of the trend towards a single pan-European market place, and from economic operators established outside the EU. Consolidation within the sector has been driven to a great extent by the need for efficiency but cost reduction strategies manifest themselves in various ways. These developments are accelerated by the emergence of a wider regulatory framework for an integrated European financial services market as set out in the Financial Services Action Plan. This regulatory framework increases the competition between suppliers of insurance and financial services through the steady move towards a level playing field. In this environment, economic operators have developed various techniques for improving their own competitiveness but some of the more common basic techniques include

the following:

-outsourcing of activities (with the intention of lowering administrative and labour costs,

e.g.: depository of shares, administrative tasks etc.);

-pooling of activities (with a cost-sharing intention, e.g.: the common development of

computer systems and software for several banks, the creation of credit factories which

may either be associated with consolidation or be undertaken on the basis of);

-sub-contracting (insertion of a supplementary distribution level for the financial products or insurances).

These techniques involve less value in created in-house but supplied as services by independent third parties to the suppliers of insurance and financial products. This generates the problem that such services may no longer come under the exemption for financial and insurance services and are therefore invoiced

with VAT. This VAT is often not deductible for the client because he has no right of deduction since he supplies himself exempt insurance and financial services. Such non-deductible VAT becomes part of the costs. The proposal contains elements which will reduce that impact on the costs.

Accordingly, the **objectives of this proposal** are twofold:

- increasing legal certainty for economic operators and national tax administrations, reducing their administrative burden for correctly applying the rules for the VAT exemption of insurance and financial services;
- reducing the impact of hidden VAT in costs of insurance and financial services providers.

These objectives are achieved by the **three measures** contained in the proposal:

- clarification of the rules governing the exemption from VAT for insurance and financial services;
- broadening of the existing option for taxation by transferring the right to opt from the Member States to the economic operators;
- introduction of a cost-sharing group which allows economic operators to pool investments and redistribute the costs for these investments exempt from VAT from the group to its members.

Clarification of rules: clarification consists of the following elements:

- the conditions for applying the VAT exemption are based on objective economic criteria decoupling them from an interpretation based on national private law concepts which is one of the main reasons for different interpretations in the Member States (e.g. an insurance must address a risk and provide for an indemnity or a benefit). These objective economic criteria ensure also that new services which will be developed in the future will be covered by the VAT exemption if they fulfil these criteria;
- the new rules introduce the concept that the exemption shall cover the supply of any constituent element of an insurance or financial service, which constitutes a distinct whole and has the specific and essential character of the exempt service concerned;
- a common harmonised concept of intermediation is introduced for insurance and financial services;
- where possible, the new definitions also create more consistency with internal market rules (e.g. investment funds). The proposal for a Directive is accompanied by a proposal for a Regulation which enumerates in a non-exhaustive way cases which are covered by or excluded from the VAT exemption for insurance and financial services.

The option for taxation: under the broadened option for taxation, it will be the economic operator who decides if he wants to be fully taxable. Where he exercises this right, he will be able to deduct input VAT on his investments like any other economic operator. In this way a level playing field for the financial industry is created that had previously not been achieved.

At the same time Member States are given the necessary flexibility to specify the rules for applying the option, adapting it to their national tax supervision structures. Where the need arises implementing provisions could also be envisaged at Community level on the basis of Article 397 of the Directive.

Cost-sharing: under the proposed cost-sharing model, economic operators can pool

their investments (e.g.: computer technology of specialised staff) in groups which could buy these investments at better market conditions and re-distribute them exempt from VAT to the members of the group.