

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

2007/0267(CNS) - 20/06/2011

The Council took note of a **report on progress** on a draft directive and draft regulation on the value-added tax (VAT) treatment of insurance services and other financial services.

The Hungarian Presidency continued the work on the two proposals in line with the orientations received from the Council focusing, as a priority, on the definitions of exempt financial and insurance services. In the context of harmonised and modernised definition of the exemption for the management of investment funds, and as specifically requested by the Council, the Working Party examined the overall effect, as far as VAT is concerned, of the changes in the regulatory climate for these funds.

The report provides an overview of progress achieved since the beginning of the year and identifies the main issues to be addressed.

Progress made: progress has been made and a tentative agreement was reached on a number of issues including the definition of insurance and reinsurance services (except for the transfer of insurance and reinsurance contract portfolios and the processing of insurance and reinsurance claims), currency exchange, and provision of cash.

There is also an emerging agreement among the delegations that the VAT Directive should not provide for separate rules as to the tax treatment of complex supplies with an element of credit or insurance service as these would be too rigid to reflect all possible business scenarios.

Furthermore, the discussions on the positive and negative examples in the draft regulation concerning financial transfer, financial deposit taking, account operation, currency exchange, provision of cash, securities and financial derivatives are essentially drawing to a closure.

Outstanding issues: as a result of detailed discussions, the differences in Member States' interpretation of the current rules were highlighted, but at the same time it was also revealed that delegations wished to achieve well-defined limits for the exemptions, which could pave the way for a future compromise. On the basis of these discussions, at this stage the Hungarian Presidency identified, among others, **four major outstanding issues of political importance:** 1) transfer of insurance and reinsurance contract portfolios; 2) outsourcing; 3) management of investment funds; 4) derivatives.

Transfer of insurance and reinsurance contract portfolios: according to the jurisprudence of the European Court of Justice the transfer of insurance and reinsurance contract portfolios is a taxed transaction, while under the current VAT Directive the transfer of a portfolio of credit contracts is interpreted by most Member States as being exempt. The majority of delegations are of the view that in order to avoid distortion of competition the transfer of insurance contract portfolios should also be exempt, while others point out that this would entail the widening of the scope of the current exemption, which would not be fully in line with the initial aim of the proposal.

Outsourcing: currently, the VAT Directive does not provide rules for the VAT treatment of services outsourced by suppliers of exempt financial and insurance services. The legal uncertainties are reflected by the fact that the ECJ has ruled on several occasions in this respect, and those rulings are, to a certain

extent, interpreted differently. Within the spectrum of views expressed, some delegations assert that the exemption for outsourcing should cover only those services which fulfil in effect all the specific and essential functions of an exempt financial or insurance service; other delegations would, however, exempt a wider range of services, to include those which have at least one of the core functions of financial and insurance services.

Management of investment funds: regarding management of investment funds, the main issue concerns the conditions an investment fund must meet in order for its management to be exempt. In addition, there are outstanding questions as regards which management services are covered by the exemption. The relevant ECJ rulings state that the purpose of the exemption is, particularly, to facilitate investment for small investors by means of investment undertakings, and that VAT should be fiscally neutral as regards the choice between direct investment and investment through undertakings for collective investment. Against this background, a number of Member States are of the opinion that the exemption should be limited to investment funds collecting the savings of small investors. Others argue that fiscal neutrality and competitiveness of the European fund industry would point towards inclusion of other investment funds.

Derivatives: work is still ongoing on the definition of exempt financial derivatives, on how to secure their continued exemption and on the possible introduction of a general optional tax suspension arrangement for commodity derivatives traded on regulated commodity markets.

In the opinion of the Hungarian Presidency, despite these differences there is a **common understanding that a level playing field should be achieved through the modernisation of the definitions.**

Harmonised rules would require a careful balancing of several aspects of a complex situation (level playing field, competitiveness of the sector, budgetary implications), as these cannot always be achieved without some trade-off.

A future agreement should also take into account the ongoing work on identifying the tax base for financial services. The Hungarian Presidency underlines the need to acknowledge the eventual evolution of the VAT Strategy and the initiatives on the taxation of the financial sector.