

**Opinion of the European Economic and Social Committee on the Proposal for a Council directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services**

COM(2007) 747 final — 2007/0267 CNS

(2008/C 224/28)

On 18 December 2007 the Council decided to consult the European Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on the

*Proposal for a Council directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services*

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 30 April 2008. The rapporteur was Mr Robyns de Schneidauer.

At its 445th plenary session, held on 28 and 29 May (meeting of 29 May 2008), the European Economic and Social Committee adopted the following opinion by 98 votes to none with three abstentions.

### Conclusions and recommendations

1. The EESC welcomes the efforts made by the European Commission to adapt the VAT rules on financial and insurance services to the requirements of the Single Market. The EESC especially appreciates the cooperation with directly involved stakeholders <sup>(1)</sup> in this respect as well as the public consultation that has been held on the Internet. Nevertheless, for future VAT reviews, the EESC recommends the direct involvement of all interested parties in the legislative process.

2. The EESC agrees that the proposals are a significant step towards a modern and more competitive VAT framework for financial and insurance services. However, the EESC would welcome a more thorough legislative approach to eliminate the remaining interpretation difficulties and unsolved problems. It cannot be stressed enough that the European Commission has to act very carefully when drafting VAT legislation on insurance and financial services. The interests of both sectors and their customers, in particular the private consumers, should not be put at stake. Besides the fact that it involves two sectors which are key to a well functioning economy and generate jobs for many European citizens, it is also a very technical matter that should leave no room for guesswork. Since one of the main concerns is increased legal certainty and the reduction of administrative burden for economic operators and national tax authorities, the meaning of the wording should be self-evident.

3. As regards the issue of VAT neutrality, the EESC is pleased about the introduction of cost sharing arrangements and the broadening of the option to tax. Given the right wording and implementation, the EESC is convinced that those instruments will reduce the impact of hidden VAT in costs of insurance and

financial services providers. This will not only improve the efficiency and competitiveness of the sector, but will also be beneficial in terms of availability of services through dedicated providers and keeping jobs onshore. Nevertheless, as the aim is to create more VAT neutrality and a level playing field for the insurance and financial sector, there are still a number of challenges. Notably a further clarification and more robust definitions are needed for a number of exemptions and concepts such as the 'specific and essential character' of exempt services as well as the scope of exempt intermediation. An acceptable solution should be found to extend the scope of the cost sharing provisions to as many operators as possible and to avoid inappropriate differences between Member States in the implementation for the option to tax. And finally, ways to avoid that VAT would come on top of other similar taxes must be explored for those services that are subject to specific domestic taxes such as notably insurance premium taxes, and that would become subject to VAT when the option to tax is used by the supplier of these services. Otherwise, the interests of consumers will be jeopardised.

### Reasons

1. *Towards a more competitive Single Market for insurance and financial services* <sup>(2)</sup>

1.1 According to the current VAT legislation no VAT is charged to the customers of most financial and insurance services. Yet, this generates undue obstacles to the achievement of an integrated, open, efficient and competitive Single Market for insurance and financial services companies. There are two main problems <sup>(3)</sup>.

<sup>(2)</sup> MEMO/07/519, 'Modernising VAT rules applied on financial and insurance services — Frequently Asked Questions', Brussels, 28.11.2007, pp.1-4.

<sup>(3)</sup> COM(2007) 747 final, 'Proposal for a Council Directive, Explanatory Memorandum', Brussels, 28.11.2007, pp. 2-4.

<sup>(1)</sup> These stakeholders are the financial operators, the insurance operators and the National Tax Authorities.

1.2 The first problem is that the definitions for VAT purposes of exempt insurance and financial services are out of date. Moreover, there is a lack of a clear delineation between exempt and taxable supplies and no Community-wide accepted method to determine recoverable input VAT. Hence, the exemption is not applied uniformly by the Member States. As a result, the last years the number of court cases submitted to the European Court of Justice (ECJ) has increased substantially. Therefore, it is necessary to fill the legislative gap and clarify the rules governing the exemption from VAT for insurance and financial services. As the Commission intends, it is wise also to allow for future developments in the financial services industry.

1.3 The second problem is that there is a lack of VAT neutrality. The suppliers of financial and insurance services are generally unable to recover the VAT they pay on the goods and services they purchase to run their businesses ('input-VAT'). This is different from non-financial businesses for whom input-VAT is not a cost: it is a tax that they collect from consumers (hence 'consumption tax') to subsequently pass it on to the State without affecting their own income. While VAT represents an important source of revenue for Member States Tax Authorities, businesses suffer the cascading effect. 'Hidden' irrecoverable VAT becomes a cost component of financial and insurance supplies. In the end this increases the cost of goods and services for consumers in general <sup>(4)</sup>.

1.4 As part of the general trend towards integration of European financial markets and the global race towards increased efficiency and competitiveness, financial and insurance companies are adopting new business models. This allows them to centralise or outsource crucial back-office and support functions to so-called 'centres of excellence' that perform these functions horizontally for groups of operators. Such business models notably allow more effective use of know-how and investments, resulting in higher-quality products at lower cost. However, this generates the problem that additional costs are created when such services are invoiced with VAT to financial and insurance operators. Hence the cascading effect as described above.

1.5 The objective of the VAT legislation review is to provide on the one hand an updated and more uniform application of the VAT rules, creating more legal certainty and reducing the administrative burden for economic operators and administrations. To address the issue of VAT neutrality, the proposal (VAT Directive) on the other hand invites financial and insurance institutions to reduce the costs of non-deductible VAT by allowing them to opt to provide services under VAT and by allowing them to avoid the creation of irrecoverable VAT by clarifying and extending the tax exemption for cost sharing arrangements, including those which are cross-border.

<sup>(4)</sup> Battiau P., (2005), 'Letter from Brussels. VAT in the Finance Sector', in: *The Tax Journal*, 28.11.2005, pp. 11-14.

## 2. The common system of value added tax: legislative approach <sup>(5)</sup>

2.1 For over thirty years the Sixth VAT Directive (77/388/EC) has represented the foundation of the common European framework for VAT. However, numerous amendments made it complicated to read and hard to access for practitioners. As from 1 January 2007, the new European Community VAT Directive entered into force (2006/112/EEC), enhancing clarity, rationality and simplification without, however, entailing content changes.

2.2 As part of its drive to modernise and simplify taxation rules for financial and insurance services, the European Commission proposed another amendment to the EU's VAT legislation in November 2007 <sup>(6)</sup>. The proposals are part of the Commission's Strategy for the Simplification of the Regulatory Environment (Section 66 of COM(2006) 690). The new definitions also aim to create more consistency with internal market rules (e.g. investment funds, credit rating, derivatives).

2.3 The current proposal for a Council Directive on the common system of value added tax, as regards the treatment of insurance and financial services, provides amendments on Articles 135(1)(a) to (g) and 137(1)(a) and (2) of the VAT Directive (2006/112/EC). This proposal is accompanied by a proposal for a Regulation <sup>(7)</sup> (VAT Regulation) that consists of provisions implementing the relevant articles of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax for insurance and financial services. It lists the financial, insurance, management and intermediation services that qualify and that do not qualify for VAT exemption as well as the services which have the specific and essential character of an exempt service and that therefore qualify for exemption in their own right. In light of the complexity of the financial services and insurance markets and the continued development of new products, these lists are not exhaustive.

## 3. Consultation of interested parties and impact assessment <sup>(8)</sup>

3.1 Stakeholders were consulted from 2004 till 2007 and an independent study was commissioned by the European Commission, all confirming the need for a VAT legislation

<sup>(5)</sup> COM(2007) 747, 'Proposal for a Council Directive, Explanatory Memorandum', Brussels, 28.11.2007, pp. 2-4.

<sup>(6)</sup> COM(2007) 747: Proposal for Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services.

<sup>(7)</sup> COM(2007) 746: Proposal for a Council Regulation laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services.

<sup>(8)</sup> COM(2007) 747 final, 'Proposal for a Council Directive, Explanatory Memorandum', Brussels, 28.11.2007, pp. 2-6.

review for the insurance and financial sector. The options considered are described extensively in the impact assessment <sup>(9)</sup> of DG TAXUD.

3.2 In 2004 a Fiscalis seminar for national tax administrations of Member States took place in Dublin. The seminar discussed the various problem areas for economic operators, in particular the global and Internal Market evolutions explaining especially the outsourcing phenomenon. During 2005 the dialogue with the main stakeholders was intensified. Regular contacts were established with representative groups such as the European Banking Federation (FBE), the Comité Européen des Assurances (CEA), the European Federation of Insurance Intermediaries (BIPAR) and the European Fund and Asset Management Association (EFAMA) as well as professional advisors and other interested parties.

3.3 In the follow-up to the first Fiscalis Seminar, DG TAXUD commissioned a study with an independent expert to increase the understanding of the economic effects of the VAT exemption for financial and insurance services <sup>(10)</sup>. The final report was presented to the Commission in November 2006 and concluded, amongst other things, that <sup>(11)</sup>:

- a) EU financial institutions are less profitable than their equivalents in other highly developed economic regions such as the US. The EU financial institutions suffer more embedded — non-recoverable and cascading — VAT. This increases their costs;
- b) there is evidence that due to divergences between Member States in interpreting the VAT Directive on what constitutes exempt or non-exempt financial services, economic operators face considerable legal uncertainty in making commercial decisions. This appears to be a significant issue in deciding what is outsourced and what is not;
- c) differences in the interpretation of the decisions of the ECJ and in the calculation of recovery rates were seen as sources of distortion which contribute to a lack of VAT neutrality. The study concluded that the current VAT treatment of financial services will in the medium term become 'a source of unfair competitive advantage' and 'frustrate the realisation of a Single Market for financial services'.

<sup>(9)</sup> SEC(2007) 1554, Commission Staff Working Document, 'Accompanying document to the Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services: Impact Assessment', Brussels, 28.11.2007, pp. 1-61.

<sup>(10)</sup> Price Waterhouse Coopers, Tender no Taxud/2005/AO-006, 'Study to increase the Understanding of the Economic Effects of the VAT Exemption for Financial and Insurance Services', Brussels, 2006, pp. 1-369.

<sup>(11)</sup> SEC(2007) 1554, Commission Staff Working Document, 'Accompanying document to the Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services: Impact Assessment', Brussels, 28.11.2007, pp. 12-13.

3.4 A subsequent series of consultations with Member States and DG MARKT resulted in the elaboration of a basic document, Working Document TAXUD 1802/06 that was discussed with stakeholders and Member States in the Tax Conference in Brussels in May 2006. The Working Document outlines the basic problems as well as possible technical measures to address them.

3.5 From 9 May 2006 to 9 June 2006, an open consultation was held over the Internet. The European Commission received 82 responses <sup>(12)</sup>. The contributions made by stakeholders in the public consultation on financial and insurance services have led to three main conclusions. Firstly, whatever options are chosen for modernising the VAT treatment of financial and insurance services, they should lead to more legal certainty and clarity and reduce the administrative charges for providers, subcontractors, intermediaries and customers. Secondly, economic operators from the insurance sector and those from the financial services sector essentially share the same concerns but might prioritise the measures to address these issues differently. Thirdly, the interests of economic operators for 'business-to-business' (B2B) supplies differ considerably from their interest regarding 'business-to-consumer' (B2C) supplies.

3.6 In June 2007, the working documents containing first legal drafts were published on the Directorate General's website. Draft legislation was extensively discussed with all stakeholders during several meetings. A VAT Stakeholders Roundtable was organised on 31 July 2007. On 28 November 2007, The European Commission adopted and communicated the above-mentioned proposals as well as the impact assessment.

3.7 In the impact assessment, DG TAXUD enumerates the expected impact of the proposal for private consumers, business consumers, the European financial and insurance companies, and the national tax administrations. This assessment <sup>(13)</sup> was notably based on the results of the study on the understanding of the economic effects of the VAT exemption for financial and insurance services. Depending on various factors — such as the standard VAT rate, the existing VAT treatment of financial and insurance services, interdependency with other taxes such as payroll taxes, the impact on social security and unemployment costs, etc. — the budgetary impact is expected to vary from one EU Member State to another. Nonetheless, based on the PwC-study <sup>(14)</sup> the following expectations can be listed up <sup>(15)</sup>:

<sup>(12)</sup> The public consultation document (Consultation Paper on modernising Value Added Tax obligations for financial services and insurances) and a detailed summary of the views expressed by respondent's (Summary of results — Public consultation on financial and insurance services) can be found at: [http://ec.europa.eu/taxation\\_customs/common/consultations/tax/article\\_2447\\_en.htm](http://ec.europa.eu/taxation_customs/common/consultations/tax/article_2447_en.htm).

<sup>(13)</sup> Price Waterhouse Coopers, Tender no Taxud/2005/AO-006, 'Study to increase the Understanding of the Economic Effects of the VAT Exemption for Financial and Insurance Services', Brussels, 2006, pp. 162-174.

<sup>(14)</sup> See footnote 10.

<sup>(15)</sup> MEMO/07/519, 'Modernising VAT rules applied on Financial and Insurance services — Frequently Asked Questions', Brussels, 28.11.2007, pp. 2-4.

**3.7.1 Budgetary impact for private and business consumers:** at present insurance and financial services are generally VAT exempt. A wider access to the option to tax should in no way increase the final cost of financial services for consumers. For financial services transactions, the non-recoverable VAT part of the price of products is a so-called 'hidden tax'. The option to tax would remove this hidden tax and should allow businesses to become more efficient and therefore allow products to be offered at lower cost. The same logic applies for the cost sharing arrangements. This is however only an assumption based on experience with the option to tax in countries such as Belgium. Additional work will be done to further assess what the actual impact of the option to tax on the business models and cost of financial products will be in various market segments. Private retail consumers should benefit from the most favourable option and suffer no disadvantage from the application of VAT to the other market segments.

**3.7.1.1** For business customers, it would be highly unlikely that an option to tax would have adverse consequences, as they can in principle recover input-VAT. The possible budgetary consequences for private consumers in the unlikely event that the option to tax would be applied to B2C operations are less clear. Since private consumers can not deduct VAT, a problem of VAT coming on top of other similar taxes might specifically arise as regards to the payment of insurance premiums. Today, those premiums are invoiced with national based taxes and parafiscal charges for the specific reason that the National Tax Authorities can not levy VAT on insurance services. However, the eventual outcome depends on the extent to which financial and insurance companies will effectively use the option to tax in a B2C environment.

**3.7.2 Employment impact:** it is important to note that budgetary impact does not only refer to the amount of the VAT revenue. The EESC is keen to ensure that VAT solutions like option to tax and cost sharing arrangements will contribute to attracting and keeping key industry sectors in the Member States. On the one hand, this guarantees direct employment in the financial services and insurance industry. On the other hand, this generates indirect employment in the Member States. Indirect employment can be created in other sectors such as ICT and other providers of outsourcing services. This also includes the suppliers of goods and services to the financial and insurance institutions (e.g. providers of hardware, security services, catering, suppliers of construction and real estate services ...). The proposals should prevent European operators from offshoring their operations (i.e. move functions to countries outside Europe) as, if designed and implemented effectively, the new rules would create an attractive proposition for businesses to centralise or outsource activities within the EU. This is based on analysis of normal business practice taking into account the importance of local knowledge and control chains. Still, it does obviously not guarantee that European operators will in the future not decide to move any activities off shore. Therefore, the

EESC is particularly sensitive to the right balance between competitiveness and job quality.

**3.7.3 Expected impact for the European financial and insurance companies:** the European Commission expects that the clarification of the definitions of exempt financial and insurance services will reduce compliance costs. Nowadays businesses have to ascertain the interpretation of the exemption with each individual Member State and are often forced to rely on the European Court of Justice. This is not only a major cost; it is also a barrier to European integration and international competitiveness. Consistent interpretation will mean that an interpretation applied in one Member State will be valid elsewhere. In addition, the wider access to cost sharing arrangements and the option to tax will help financial and insurance companies to better manage the impact of non-recoverable VAT on their internal cost structure. This will increase the profitability of financial and insurance operators, allowing them to better compete in the global marketplace and to lower the cost of capital and insurance for the European economy and for consumers in general.

**3.7.4 Budgetary impact for national tax administrations:** the Commission is convinced that an increase of legal certainty will secure the taxing rights of Member States and reduce opportunities for aggressive tax planning. In addition, the administrative burden for national tax administrations should decrease because of more obvious exemption rules. However, a more consistent application of the exemption cannot exclude that some Member States will have to exempt certain services which they now consider as taxable and vice versa. Yet, based on a high level assessment, the Commission assumes that the overall effect of the revenue implications will be small or even neutral. More profitable insurance and financial companies will have to pay more direct taxes and accordingly will contribute to the national budgets. Furthermore, much of the VAT that would theoretically be lost in such cases of implementation of cost sharing arrangements is not actually levied today as operators minimise this cost of centralising functions by appropriate but complicated and administrative burdensome organisational measures.

**3.7.4.1** Still, the European Commission indicates that it is difficult to estimate the effect of these VAT solutions. Much will depend on how the financial and insurance institutions will react to the changes. For cost sharing, the reduction in the tax collection depends on whether the arrangements are already in place and subject to VAT or not. If the new rules encourage financial and insurance companies to enter into efficiency-driven arrangements which they would otherwise not have contemplated, there would not be any loss of VAT. If the arrangements are already in place and subject to VAT, which is highly unlikely, then there may be a revenue loss because of more extensive relief. As regards the changes in the rules on

option to tax, a net tax outflow in business-to-business (B2B) operations may be expected because business customers are generally able to recover the VAT they pay. On the other hand, taxing business-to-customer (B2C) operations would theoretically produce tax revenue gains. It is however uncertain at this stage to what extent operators would opt for taxation on financial and insurance products in a B2C environment. Financial institutions and insurance companies would have to make sure first that they will be able to increase their efficiency to a level allowing them to charge VAT to private customers without increasing the cost for these customers.

#### 4. Observations regarding insurance and financial services

4.1 The EESC fully supports the European Commission in its ambitious project to adapt the VAT rules on insurance and financial services to the requirements of the modern marketplace. The proposals are clearly aimed at addressing the main areas of concern for the finance and insurance industry and their consumers whereas the approach that has been chosen, i.e. a draft Directive with implementing measures in a draft Regulation, seems sound and logical.

4.2 However, the EESC encourages the European Commission together with Member States to continue work on further clarification of a number of definitions so as to address the crucial concern of more legal certainty completely. Regarding the definitions of financial services, the EESC expresses its concerns about some of the wording in the proposals, like the granting of credit as defined in point (2) of Article 135 of the VAT Directive and in Article 15 of the VAT Regulation. These definitions are not entirely clear and seem too limiting. For instance, only the 'lending of money' is covered in general terms seemingly without dealing in a specific way with various kinds of existing or emerging solutions for providing finance, including transactions involving securities. Therefore, the EESC recommends that consideration would be given to further clarification, while allowing for further developments in the financial services industry, as the Commission is willing to.

4.3 The same recommendation applies for the proposal of Regulation. The EESC would recommend further work to be done to ensure that the list of examples used in the Regulation is entirely clear and consistent. The EESC understands that, in theory, the Regulation does not include exhaustive lists of definitions, but the EESC is concerned about the risk of confusion and about the unknown implications in practice of the financial and insurance services that are not specifically mentioned in the list.

4.4 Consideration should be given to generate more certainty in respect of the categories of payments services, derivatives, securities and custodial services and the scope of the exemption for specific services regarding management of investment funds. As regards the services which are deemed to have the specific and essential character of an exempt service, the EESC believes that additional clarification might be required on the concept of 'essential' and 'specific' <sup>(16)</sup>. The proposals do not always appear to be giving a sufficiently clear view of which administrative actions are actually considered to qualify as specific and essential whereas the lists do not always appear to be fully consistent as services belonging to the same value chain would sometimes appear to be treated differently.

4.5 As regards intermediation, more clarity is needed as to the definition of 'contractual party' and of 'standardised services' <sup>(17)</sup>. Intermediation should also be included in the definition of services that are 'essential' and 'specific' to an exempt service <sup>(18)</sup>. Otherwise, intermediaries would no longer be operating in a level-playing field. It would also be contrary to the intended new philosophy of the proposed exemptions, which look at the provision of the service and not to the person who is providing it or to the means that are used to provide it.

4.6 Special attention should be paid to services such as pensions and annuities which will benefit from exemption under different exemption categories. According to the presence or absence of risk, it will be insurance <sup>(19)</sup> or financial deposit <sup>(20)</sup>. The problem is that the concept of related services (the back office) will be developed separately and differently <sup>(21)</sup>. As a result, the unitary products at stake will have to be supported by two different VAT categories of essential and specific services according to their qualification under the main exempt supply.

4.7 The EESC welcomes the extension of the right for operators to opt for taxation of banking and insurance services and the introduction of cost sharing arrangements as a mean to reduce the impact of hidden VAT. However, the EESC fears that the strict conditions for eligibility for cost sharing as well as the strict scope of the services that could be supplied within a VAT-neutral cost sharing arrangement will in practice reduce the potential benefit of cost sharing provisions to a very limited number of situations.

<sup>(16)</sup> See Article 135, 1, (a) of the proposed VAT Directive and Article 14, 1 of the proposed VAT Regulation.

<sup>(17)</sup> See Article 135 a, (9) of the proposed VAT Directive and Article 10, 1-2 of the proposed VAT Regulation.

<sup>(18)</sup> See Article 135, 1, (a) of the proposed VAT Directive.

<sup>(19)</sup> See Article 2, 1 of the proposed VAT Regulation.

<sup>(20)</sup> See Article 5, 1, h of the proposed VAT Regulation.

<sup>(21)</sup> See Article 14 and 17 of the proposed VAT Regulation.

4.8 A general introduction of VAT Grouping (treating groups of companies as one single tax payer for VAT purposes, as provided for in the current VAT-Directive but only on an optional basis) with appropriate anti-abuse provisions, could prove a more appropriate and flexible solution allowing operators to integrate their core functions without incurring additional VAT. However, the EESC admits that support for the implementation of VAT Grouping provisions is not unanimous among Member States at this time and that also the Commission has reservations. It would therefore not appear to be a solution in the short term.

4.9 The EESC welcomes the introduction of a generalised option to tax that is not currently available for insurance services. The merits of this option are clear in B2B transactions, where VAT is recoverable by the customer. Yet, the EESC fears that additional taxation might arise under the new legislation and have budgetary consequences for private consumers who can not recover VAT. Whatever law applies to contracts, insurance contracts are subject to indirect taxes and parafiscal charges on insurance premiums in the Member State in which the risk is located. The rate of those taxes varies significantly among Member States and between classes of insurance (e.g. life insurance, motor liability, etc.). This gives rise to questions

about the need of EU-wide coordination. The EESC doubts that insurance companies will apply the option to tax especially in B2C markets, as long as the national tax authorities levy other taxes on insurance premiums. On the other hand, the EESC considers it unlikely that national authorities will abolish, or to at least, reduce in due proportion the premium taxes since this will generate revenue losses for Member States. This is a matter clearly to be addressed.

4.10 As regards the option to tax for insurance and financial services, the EESC would also welcome a system allowing operators to opt on a transaction-by-transaction basis or on a per-client basis or for pre-defined categories of transactions or clients. At the same extent, allowing operators to be able to appropriately recover the input-VAT that relates to the VAT-able output would be welcome. This would create maximal VAT-neutrality in a B2B environment. However, it is crucial that a uniform implementation of the option is safeguarded as from 2012, and that therefore Member States will not be given the possibility to impose differing conditions for the use of the VAT option. If the option to tax is not implemented in a similar way, it is likely that distortions of competition between Member States and economic operators will be created.

Brussels, 29 May 2008.

The President  
of the European Economic and Social Committee  
*Dimitris Dimitriadis*

---