



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 28.11.2007
COM(2007) 747 final

2007/0267 (CNS)

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**

(presented by the Commission)

{SEC(2007) 1554}

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EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Grounds for and objectives of the proposal

The objectives of the 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 re-distribute the costs for these investments exempt from VAT from the group to its members.

Clarification of rules

The clarification of the rules governing the exemption from VAT for insurance and financial services has the objective to provide a more uniform application of the VAT exemption, creating more legal certainty for economic operators and reducing the administrative burden for economic operators to comply with the rules. This 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 interpretation and application 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 that also 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 this was 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 was not achieved so far as only very few Member States have granted the option to business and this under differing conditions.

At the same time Member States are given the necessary flexibility to specify themselves the rules for applying that 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, in particular smaller economic operators can pool their investments (e.g.: computer technology of specialised staff) in groups which can buy these investments at better market conditions and re-distribute them exempt from VAT to the members of the group.

• General context

The definitions of exempt insurance and financial services are out of date and have led to an uneven interpretation and application of these exemptions by Member States. Stakeholders are confronted with a considerable legal complexity of 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 objectives to create more legal certainty and to reduce the administrative charges for operators and administrations. A public consultation of stakeholders carried out in 2006 and an independent "Study to increase the Understanding of the Economic Effects of the VAT Exemption for Financial and Insurance Services" commissioned by the Commission confirmed this conclusion.

The 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 as well as 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 emerging 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 that less value is 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 for deduction as 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.

- **Existing provisions in the area of the proposal**

Articles 135(1)(a) to (g) and 137(1)(a) and (2)

- **Consistency with the other policies and objectives of the Union**

Where this was possible, the new definitions also create more consistency with internal market rules (e.g. investment funds, credit rating, derivatives).

The proposal is part of the Commission's Strategy for the Simplification of the Regulatory Environment (Section 66 of COM(2006) 690). Both economic operators and Member States' tax authorities will benefit from these simplifications. However, it is not possible to quantify these benefits.

The proposal will improve legal certainty and reduce the administrative burden of operators and national tax authorities. As it would have a positive impact on costs, it should not have negative effects on the cost of retail consumer insurance and financial services.

2. CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

Consultation methods, main sectors targeted and general profile of respondents

Fiscalis seminar, December 2004 in Dublin with representatives from the insurance and financial services industry and from the fiscal authorities of Member States

Tax Conference in Brussels on 11 May 2006 with representatives from the insurance and financial services industry and from the fiscal authorities of Member States

Public consultation of stakeholders in June 2006

Fiscalis seminar in March 2007

Publication of working documents containing first legal drafts on the Directorate General's website in June 2007

Roundtable with stakeholders in July 2007

Summary of responses and how they have been taken into account

The Fiscalis seminar in December 2004 in Dublin analysed the various problem areas for economic operators, in particular the outsourcing phenomenon and led to the conclusion by both, economic operators and Member States that a legislative initiative of the Commission services is required.

In the follow-up to this seminar DG TAXUD services commissioned a study with an independent expert to increase the understanding of the economic effects of the VAT exemption for Financial and Insurance services and undertook a series of bilateral consultations with Member States and DG MARKT which resulted in the elaborating of a basic document (Working Document Taxud 1802/06) outlining the basic problems which were identified as well as possible technical measures to address them. This document was discussed with stakeholders and Member States in the Tax Conference in Brussels in May 2006.

A second Fiscalis seminar was held in March 2007 with the objectives of familiarising concerned officials from the national tax administrations with the policies driving change in the regulatory framework, and the economic drivers for cross-border financial integration. The programme also covered practical implementation issues in the current legislation.

Draft legislations was extensively discussed with all stakeholders involved.

An open consultation was conducted over the internet from 9 May 2006 to 9 June 2006. The Commission received 82 responses. The results are available on http://ec.europa.eu/taxation_customs/common/consultations/tax/article_2447_en.htm

• **Collection and use of expertise**

Scientific/expertise domains concerned

Study to increase the understanding of the economic effects of the VAT exemption for Financial and Insurance services (Tender no taxud/2005/AO-006)

Methodology used

independent outside study

Main organisations/experts consulted

Price Waterhouse Coopers

Summary of advice received and used

The existence of potentially serious risks with irreversible consequences has not been mentioned.

There was broad consistency between the conclusions of the study, the Commission's own analysis in Working Document Taxud 1802/06 and the reactions from stakeholders in the public consultation, allowing Directorate General Taxation and Customs Union to impose the necessary priorities and focus its work on the most appropriate solutions.

Means used to make the expert advice publicly available

Publication on the Directorate General's website

http://ec.europa.eu/taxation_customs/common/publications/studies/index_en.htm

• **Impact assessment**

The options which were considered, are described extensively in the impact assessment

Zero rating on page 31

Extending the scope of exempted services on page 32

Uniform limited input tax deduction on page 33

Option to tax on page 34

Cross border VAT bodies on page 37

Single legal entities and cross-border transactions on page 37

VAT grouping on page 38

Cost sharing arrangements on page 41

Reduced VAT rate for bought-in service on page 44

Other options on page 44

The Commission carried out an impact assessment listed in the Work Programme, whose report is accessible on Document Taxud 15570.

3. LEGAL ELEMENTS OF THE PROPOSAL

• **Summary of the proposed action**

This proposal consists of three measures:

- 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 re-distribute the costs for these investments exempt from VAT from the group to its members.

- **Legal basis**

Article 93 of the Treaty

- **Subsidiarity principle**

The proposal falls under the exclusive competence of the Community. The subsidiarity principle therefore does not apply.

- **Proportionality principle**

The proposal complies with the proportionality principle for the following reason(s).

The proposals are contained in a draft Directive; there can only be one correct interpretation of the rules governing the VAT exemption for insurance and financial services which apply throughout the Community; this objective can only be achieved by amending the old rules in Directive 2006/112/EC. Allowing suppliers of exempt insurance and financial services to group their investments and re-distribute these exempt from VAT from the group to its members requires an appropriate vehicle which works also in cross-border scenarios; the creation of such a vehicle can only be achieved by an amendment of Directive 2006/112/EC.

Clear rules based on economic criteria reduce the substance for possible litigation and therefore generate an environment of legal certainty within which the administrative charges for agreeing possibly with several Member States on how the rules are to be interpreted and applied are considerably reduced.

- **Choice of instruments**

Proposed instruments: directive.

Other means would not be adequate for the following reason(s).

The existing Council Directive 2006/112/EC can only be amended by another Directive.

4. BUDGETARY IMPLICATION

The proposal has no implication for the Community budget.

5. ADDITIONAL INFORMATION

- **Simplification**

The proposal provides for simplification of legislation.

The proposal includes the following elements of simplification:

- it bases the conditions for applying the VAT exemption on objective economic criteria which make the exemption from VAT more manageable;
- it clarifies that the exemption covers 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; this reduces the potential for litigation;
- it introduces a common harmonised concept of intermediation for insurance and financial services; the same principles apply to insurances and financial services.

- **Correlation table**

The Member States are required to communicate to the Commission the text of national provisions transposing the Directive as well as a correlation table between those provisions and this Directive.

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amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 93 thereof,

Having regard to the proposal from the Commission¹,

Having regard to the opinion of the European Parliament²,

Having regard to the opinion of the European Economic and Social Committee³,

Whereas:

- (1) The financial service industry makes an important contribution to growth, competitiveness and job creation but can fulfil its role only under neutral conditions of competition in an internal market. It is necessary to provide a framework which provides legal certainty as to the value added tax (VAT) treatment of financial products and their marketing and management.
- (2) The existing rules governing the exemptions from VAT for financial and insurance services laid down in Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax⁴ are out of date and have led to uneven interpretation and application. The complexity of the rules and the variation in administrative practices generates legal uncertainty for economic operators and tax authorities. This uncertainty has led to considerable litigation and has increased the administrative burden. It is therefore necessary to clarify which insurance and financial services are exempt and thereby create greater legal certainty and reduce the administrative burden for operators and authorities.
- (3) In order to ensure tax neutrality, the exemptions should be linked to the nature of the services concerned, on the basis of objective economic criteria, and not to the persons supplying them.

¹ OJ C , , p. .

² OJ C , , p. .

³ OJ C , , p. .

⁴ OJ L 347, 11.12.2006, p. 1. Directive as amended by Directive 2006/138/EC (OJ L 384, 29.12.2006, p. 92).

- (4) Particular uncertainty arises where economic operators outsource activities to independent persons or pool activities between operators. To avoid such uncertainty, it is appropriate to make it clear that activities which form a constituent element of an insurance or financial service, constitute a distinct whole and have the specific and essential character of the exempt service fall within the exemption applying to the service concerned.
- (5) Insurance services and financial services require similar forms of intermediation. It is therefore appropriate for intermediation in insurance and intermediation in financial services to be treated in the same way.
- (6) The modernisation of the exemptions for insurance and financial services seeks also to ensure consistency with internal market provisions, in particular the Financial Services Action Plan⁵ and the rules governing undertakings for collective investments in transferable securities. Nevertheless, in order to observe the requirement for strict interpretation of VAT exemptions, it is in some cases necessary for the definitions of exempt insurance and financial services to be narrower than the definitions provided for in the internal market rules.
- (7) Suppliers of insurance and financial services are increasingly able to allocate input VAT on costs incurred by them precisely to the output to be taxed. Where the services they supply are fee-based, they can establish the taxable amount for these services easily. It is therefore appropriate to extend the possibility to opt for taxation for such operators.
- (8) By strengthening cross-border co-operation, providers of insurance and financial services may increase their competitiveness and contribute to the realisation of the internal market. Subject to compliance with the principle of tax neutrality, the economic operators concerned should therefore be given the right to opt for taxation and to co-operate on a cost-sharing basis.
- (9) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Directive 2006/112/EC is amended as follows:

- (1) Article 135 is amended as follows:
 - (a) In paragraph 1, points (a) to (g) are replaced by the following:
 - "(a) insurance and reinsurance;
 - (b) granting of credit and guaranteeing of debts resulting from the granting of credit;

⁵ COM(1999) 232.

- (c) transactions concerning financial deposits and account operation;
- (d) exchange of currency and provision of cash;
- (e) supply of securities;
- (f) intermediation in insurance and financial transactions as referred to in points (a) to (e);
- (g) management of investment funds;"

(b) The following paragraphs 1a, 1b and 1c are inserted:

"1a. The exemption provided for in points (a) to (e) of paragraph 1 shall apply to 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.

1b. Where a complex transaction includes an element of insurance which is set out separately, the insurance shall be a distinct service exempted under point (a) of paragraph 1.

1c. Where the supply of goods or services includes the granting of credit which is not set out separately, the grant of credit shall not be a distinct service exempted under point (b) of paragraph 1."

(2) The following Article 135a is inserted:

"Article 135a

For the purposes of applying the exemptions provided for in points (a) to (g) of Article 135(1), the following definitions shall apply:

- (1) "insurance and reinsurance" means a commitment whereby a person is obliged, in return for a payment, to provide another person, in the event of materialisation of a risk, with an indemnity or a benefit as determined by the commitment;
- (2) "granting of credit" means the lending of money or the promise to lend money;
- (3) "guaranteeing of debts" means the acceptance of liability for the debt of another person;
- (4) "financial deposit" means a deposit of money held on behalf of the depositor who retains rights to the deposits, which must be repaid under the legal and contractual conditions applicable;
- (5) "account operation" means the operation of a monetary account for a customer;
- (6) "exchange of currency" means the supply of services whereby a person changes the currency of bank notes or coins normally used as legal tender, of

deposits or of money in a monetary account on the basis of rates of exchange between currencies of countries;

- (7) "cash" means bank notes and coins normally used as legal tender or negotiable means of payment;
 - (8) "supply of securities" means the supply of tradable instruments other than an instrument establishing title to goods or to the rights referred to in Article 15(2), representing financial value and reflecting any one or more of the following:
 - (a) an equity ownership position in a company or other association;
 - (b) a creditor's position for debts;
 - (c) unit ownership in undertakings for collective investment in the securities referred to in points (a) or (b), in other exempted financial instruments referred to in points (a) to (d) of Article 135(1) or in other undertakings for collective investment;
 - (9) "intermediation in insurance and financial transactions" means the supply of services rendered to, and remunerated by, a contractual party as a distinct act of mediation in relation to the insurance or financial transactions referred to in points (a) to (e) of Article 135(1), by a third party intermediary;
 - (10) "investment funds" means undertakings for collective investment in the exempted financial instruments referred to in points (a) to (e) of Article 135(1) and in real estate;
 - (11) "management of investment funds" means activities aimed at realising the investment objectives of the investment fund concerned."
- (3) In Article 137(1), point (a) is deleted.
 - (4) The following Articles 137a and 137b are inserted:

"Article 137a

1. From 1 January 2012, Member States shall allow taxable persons a right of option for taxation in respect of the services referred to in points (a) to (g) of Article 135(1).
2. The Council shall adopt the measures necessary for the implementation of paragraph 1 pursuant to the procedure provided for in Article 397. So long as the Council has not adopted such measures, Member States may lay down the detailed rules governing exercise of the option under paragraph 1.

Article 137b

Member States shall exempt services supplied by a group of taxable persons to members of the group where the following conditions are fulfilled:

- (1) the group itself and all its members are established or resident in the Community;
 - (2) the group carries out an autonomous activity and acts as an independent entity towards its members;
 - (3) members of the group are supplying services which are exempt under Article 135(1)(a) to (g) or other services in respect of which they are not taxable persons;
 - (4) the services are supplied by the group only to its members and are necessary to allow members to supply services which are exempt pursuant to Article 135(1)(a) to (g);
 - (5) the group claims from its members only the exact reimbursement of their share of the joint expenses, excluding any transfer-pricing adjustments made for the purposes of direct taxation."
- (5) In Article 174(2), point (c) is replaced by the following:
- "(c) the amount of turnover attributable to financial transactions as referred to in points (b) to (g) of Article 135(1) in so far as those transactions are incidental."

Article 2

Transposition

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 December 2009 at the latest. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 3

This Directive shall enter into force on the [...] day following that of its publication in the *Official Journal of the European Union*.

Article 4

This Directive is addressed to the Member States.

Done at Brussels, [...]

*For the Council
The President*