

Proposal for improvement of EU-legislation

Review of rules in the VAT Directive (2006/112/EC) affecting insurance and financial services

Area

Taxation/VAT

Legislation

Directive 2006/112/EC on the common system of value added tax

Burden on business

According to the current EU VAT legislation no VAT is charged to the customers on most financial and insurance services. However, the financial industry, including the insurance industry, does indeed also supply many taxable services. This means that financial entities are constantly faced with the obligation to determine whether the service supplied is a single taxable or exempt service, a supply which is ancillary to the main taxable or exempt supply or a distinct and independent taxable or exempt supply of a service. This analysis affects the company's tax liabilities and if the result is not shared by the Tax Agency it may lead to heavy penalties and charges of additional tax. The fact that the price of financial services often involves high amounts, the effect of diverging views regarding tax liability may be extremely costly. Thus, a better definition of the exempted services according to the Directive is urgent.

New products and business models, technical development and a new market structure with new financial operators within the EU enhances the tax problems further. In order to avoid the burden of having to distinguish what part or parts in a bundled service to a customer is an exempt service or a taxable service financial companies should be given a strict option to tax exempted services.

Moreover, the exemption for financial and insurance services is not applied uniformly within the EU. This uncertainty has led to a significant growth in litigation with the Court of Justice of the European Union (CJEU) being asked to interpret the legislation with increasing frequency. This process can be initiated by either businesses or tax administrations, both of whom are faced with ambiguity and uncertainty. It is a slow and cumbersome process and the decisions by the CJEU are far from clear and very often create new problems. Divergent interpretation of the CJEU cases by individual Member states has increased legal uncertainty for financial companies operating in several countries on the EU single market. Some of the most recent cases creating huge uncertainty and burden are C-7/13, Skandia America (VAT grouping), C-605/15, Aviva, C-326/15, DNB Banka and C-616/15, Commission v Germany (cost sharing). The increased administrative burden created by the court cases should be solved by amending the rules on cost sharing and VAT grouping.

Since the legislation in the VAT Directive was adopted in 1977 it had not been revisited until 2007 when the European commission presented a package to review the exemption including cost sharing. Unfortunately, the package was withdrawn by the Commission in 2016 due to lack of progress in Council. However, due to progress in other areas for the free movement of capital and supply of financial services cross border within the EU, the need for a review is now greater than ever.

Simplification proposal

Re-examine the scope of the exemptions and clarify the definitions of the different exempted insurance and financial services in Article 135.1 a)-g). Amend Article 137 and introduce a wide option to tax for the industry. Review Article 132.1 f) and introduce cost sharing for entities carrying out insurance and financial services. Amend and clarify the rules on VAT grouping in Article 11 by treating supplies for internal use between a branch and the headquarters as out of scope for VAT, even if one of the entities belong to a VAT group, and allow for grouping to be applied cross-border.

Effects of the simplification proposal

- Substantive reduction in administrative burden and costs
- Better functioning of the internal market for financial and insurance services, in line with other policy areas such as the Capital Markets Union (CMU) and cross-border financing.

For further information. These reports illustrate the administrative burden and costs related to the exemption for financial and insurance services:

PWC: How the EU VAT exemptions impact the Banking Sector - Study to assess whether banks enjoy a tax advantage as a result of the EU VAT exemption system, 2011,
https://www.pwc.com/gx/en/financial-services/pdf/2011-10-18_vat_study_final_report.pdf

Copenhagen economics: Effects of VAT-exemption for financial services in Sweden: Impact on Swedish banks and their customers compared to a full VAT system, 2016
<https://www.swedishbankers.se/media/3047/effects-of-vat-exemption-for-financial-services-in-sweden.pdf>

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