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Issue 7

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Welcome to the latest edition of Deloitte's Financial Services and Insurance (FSI) Global Indirect Tax Newsletter.

We hope that you find the publication useful and we welcome your feedback. Should you have any comments or questions arising from the newsletter, please speak to your usual Deloitte contact or one of the regional FSI leaders listed below.

Kind regards

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Area in focus – Interaction between regulation in the financial services industry and the VAT treatment of financial supplies

There have been a number of cases that consider the interaction between regulation in the financial services industry and the VAT treatment of financial services supplies (*SDC* (C-2/95), *CPP* (C-349/96), *Skandia* (C-240/99) and *Mapfre* (C-584/13) to name but a few).

It is common in many countries to use financial regulation as a tool to help classify supplies for VAT purposes, whereas other countries choose to disregard it and focus on the importance of the substance of the supply. Set out below are the different approaches taken in a snapshot of EU countries to the VAT treatment of insurance and fund management services to illustrate this point:

Insurance and insurance intermediary services

Country	Industry regulation is: Determinative	Persuasive	Disregarded	Comments
Denmark			√	The Danish tax authorities tend to follow the principles in CJEU rulings (i.e. to look at the substance of the service) as opposed to whether the supplier is regulated.
Germany			√	Only the substance of the service is relevant. Whether the supplier has regulatory approval to provide the service or not is not decisive.
Italy		√		In some cases the substance of the service may be relevant. Whether the supplier has regulatory approval to provide the service or not is not necessarily decisive.
Malta			√	Maltese legislation provides for licensed insurance providers to qualify for exemption. However, the interpretation applied, in practice, is that the VAT exemption is not restricted only to services provided by local licensees.
Portugal		√		The regulatory positions in the financial services industry are not determinative of the VAT treatment. However, they are taken into consideration. For example, a change in the concept of intermediary insurance services defined by the insurance regulator determined a formal position regarding the VAT treatment of these services.
Sweden		√		There is no clear practice on whether the regulator's classification will determine the VAT liability. However, the regulator's classification can be considered when analysing services.
UK	√		√	For insurance services the practice is to follow the insurance regulator's classification of insurance to qualify for the VAT exemption. The opposite applies to insurance intermediary services where the regulatory status of the intermediary is not determinative of the treatment.

Fund management

Country	Industry regulation is: Determinative	Persuasive	Ignored	Comments
Denmark			√	The Danish tax authorities tend to follow definitions which are also used for income tax purposes (however this may change as a result of the *Fiscale Eenheid X* case (C-595/13)).
Italy		√		In some cases the substance of the service may be relevant. Whether the supplier has regulatory approval to provide the service or not is not necessarily decisive.
Luxembourg	√			Other than those investment vehicles specifically listed under the VAT exemption, only vehicles that are regulated can fall within the exemption.
Malta	√			The regulatory status of the investment fund is determinative for the VAT treatment.
Netherlands		√		The regulatory status of the investment fund is persuasive of the VAT treatment.
UK	√			Funds must fall within the definition of those listed in the VAT exemption and these follow a number of different regulations.

To summarise the above, the common approach, as always, is to follow that of the CJEU and look at the substance of the supply rather than its regulatory status. However, it can be seen from the tables above that the regulatory positions in the financial services industry are used to determine the VAT treatment for certain financial services, particularly for fund management.

With the former approach, this does not of course mean that the regulatory status is not taken into consideration by both tax authorities and businesses. The regulatory status is often used as the starting point to obtain an accurate definition of the services that are being provided.

But, that said, recent case law demonstrates that the CJEU views the VAT exemption for financial services to apply more broadly than to purely regulated financial services and service providers. In the case of *Mapfre* (C-584/13) both the Advocate General and the CJEU concluded that, with respect to the supply of a warranty by a third party which was not involved in the sale of the underlying goods, all the elements/characteristics of an ‘insurance’ contract were present and the supply therefore fell within the VAT exemption for insurance. The result is that any third party provider of warranties (where they do not also supply the goods) should be treated as making exempt supplies regardless of whether they are regulated as an insurer or

not. This will have particular ramifications for those countries which currently treat warranty products as subject to VAT, such as the UK.

This also then raises questions as to the differences in the definition of services for different taxes. Staying with the insurance example, what is the nexus between the definition of insurance from a VAT perspective and other indirect taxes affecting the insurance industry (e.g. Insurance Premium Tax)? If the decision in *Mapfre* is followed in other countries and warranties are treated as exempt insurance products, does it then also fall within the remit of other taxes on insurance?

In conclusion, there is a varied application of how regulation of financial services affects the VAT treatment of those services. However, recent discussions and cases on this topic appear to be moving away from seeing regulation as entirely determinative of the VAT treatment. This means, more than ever, it is up to businesses to analyse their supplies in detail and with great care, to establish the VAT (and premium tax position).

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Asia Pacific

China – Update on VAT implementation

It is expected that the VAT reform in China is to be completed by the end of 2015 although this is yet to be confirmed (1 October 2015 is thought to be the earliest possible implementation date).

Possible VAT treatment in the financial services industry

Unlike other countries which operate a VAT, GST or similar indirect tax system and which do not tax financial services, China is likely to impose VAT on most financial services. Supplies of financial services are currently subject to Business Tax (BT) in China, which is to be replaced by VAT after the VAT reform.

Although the detailed VAT rules on financial services are yet to be seen, it is generally expected within the industry that the main supply of financial services (interest income, fees, trading of financial products) will be subject to VAT at 6%, which is 1% higher than the current 5% for BT. However, with the transition to VAT, taxpayers should be able to recover VAT on costs which are directly attributable to onward taxable supplies. Moreover, the current BT exemption for interest on inter-FI (financial institutions) loans could effectively remain in place by becoming VAT exempt instead.

Supplies of certain financial services to overseas customers are likely to be VAT exempt or zero-rated, subject to clarification of the final rules.

VAT on interest charged by banks to customers might not be recoverable by customers on a temporary basis due to pressures on fiscal revenue. If this is the case, this would affect the banks' ability to charge VAT to their customers from a commercial perspective and they could end up absorbing the cost.

Industry preparations

Although the detailed VAT reform rules are yet to be seen, most of the big banks (local and foreign banks) have already started preparation work due to the tight timeline. This is because banks and other businesses in the financial services industry are heavily reliant on systems and it normally takes a significant amount of time to enhance these. Therefore, it is essential that they start early and prepare for the upcoming reform.

India – Update on GST implementation

Indian GST is proposed to be implemented in April 2016, as announced by the Government of India. Currently, the power to tax goods and services is divided between the States and the Union Government, and the reform that seeks to integrate this goods and services taxation requires amendment to the Constitution of India. The Constitution Amendment Bill (the Bill) has now been passed by the Lower House of Parliament, but it is pending approval in the Upper House of Parliament, where the ruling party does not have a majority. The Bill has been referred to a Select Committee of the Upper House, and is expected to come up for discussion in the Monsoon Session of Parliament which began on the 20 July 2015.

For the FS industry, GST implementation could result in an increase in compliance requirements, since the States would also be able to levy tax on services. This is in comparison with the current regime where only the Union Government is constitutionally empowered to tax services. It could, however, also give the industry the ability to recover higher input tax credits than is the case under current laws, as the taxes on goods and services would be integrated. Service providers could, conversely, be faced with an increased rate of output tax, in comparison to the current rate of service tax of 14%.

Malaysia – Update on GST implementation

With its introduction on 1 April 2015, Malaysian GST posed unique challenges for the FS industry as the application of Malaysian GST to financial services is different to that found elsewhere (with the exception of South Africa). Most notably, 'fee based' financial services are subject to GST and the exemption is limited to 'margin based' transactions (e.g., interest, derivatives). This posed significant classification and administrative issues during the implementation period. Similar issues also existed in the insurance industry as, for example, insurance policies that include both a life (exempt) and non-life (taxable) components require separation for invoicing purposes.

In terms of ongoing issues, whilst the banking and insurance industries had quite a lengthy consultation period with the tax authorities to resolve technical positions, there is still some confusion and divergence in the market on the treatment of products and services; though much of this has been mitigated for banks through the release of an industry wide ‘Green Book’ (see below).

Amendments to law and practice have been introduced quite late in the day. For example, the insurance industry only recently had to deal with a change in the law which severely limited the ability to recover ‘deemed input tax credits’ on claim settlements on taxable policies (for more detail see the section below on this).

Some of the key areas where there is still confusion for the financial services industry as a whole includes:

- the interaction of the export rules with financial services and in particular whether exported financial services are zero-rated; and
- the reporting of financial services, as there is no clear consensus or guidelines on the values which should be reported on exempt financial supplies such as loans, derivatives, swaps, securities, and bonds.

Partial exemption rules have limited application in Malaysia, with the majority of banks being given a concession to apply a fixed input tax recovery rate (similar to the model in Singapore). However, this does not apply universally with banks based in Labuan, securities firms, unit trusts/ funds and life insurers not being able to use the fixed rate. This is exacerbated by a low *de minimis* threshold and the inability to access the concession for ‘incidental financial supplies’.

Malaysia – Industry guidance on GST treatment of financial supplies

The Association of Banks in Malaysia (ABM) has published a detailed list of commonly used banking products and services and the corresponding GST treatment that should be applied to these supplies. The list, or ‘Green Book’ as it is commonly known by, was the culmination of a lengthy consultation with the various banking associations, the Ministry of Finance and the Royal Malaysian Customs Department.

The Green Book outlines the GST treatment for the following categories of banking products and services:

- Deposit accounts
- Card services
- Trade services
- Guarantees
- Credit and Lending services

- Motor Finance
- Miscellaneous financial services

Malaysia – Restrictions on deemed input tax credit for insurance industry

When first enacted, the GST Act and GST Regulations allowed insurers to claim a deemed input tax credit (DITC) on any cash settlements made to certain categories of policy holders, in particular, policy holders who were not registered for GST or were ineligible to recover the GST paid on the premium. The concession, which exists in many other GST/ VAT regimes, was intended to compensate the insurer for the effective reduction in the margin.

However, an amendment was made to the GST Regulations just four days prior to the commencement of Malaysian GST to significantly limit the availability of DITCs. In particular, restrictions were imposed where the settlement related to:

- exempt, zero-rated or out of scope supplies; or
- any supply for which credit for input tax is blocked under GST legislation.

Due to the onerous requirements on the insurer to work out what the particular cash settlement relates to, in practice a large number of insurers are simply not claiming DITCs.

It is unclear at this stage what the cost will be to the industry as a result of these changes, but it is likely to be substantial. The industry is proceeding with further consultation with the tax authorities to have this position reversed but at the time of writing there have been no major developments in this area.

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Denmark – Guidance issued on ‘management’ of Special Investment Funds

The Danish Tax Authorities (DTA) have issued draft guidelines following the CJEU decision in *ATP Pension Service* (C-464/12). The draft guidance outlines the definition of ‘Special Investment Funds’ (SIFs), the definition of ‘management of SIFs’, and how to claim back incorrectly charged VAT retrospectively.

Suppliers to SIFs and SIFs themselves have put pressure on the DTA to clarify which services benefit from the ‘management’ VAT exemption as the current draft guidelines relating to this are not conclusive.

Denmark has a Special Payroll Duty on companies supplying VAT exempt services and therefore suppliers would prefer to limit the range of services that can be VAT exempt. On the other hand, the recipients of such services (i.e., the SIFs) are trying to broaden the scope of exempt services.

The guidelines, once implemented, will allow businesses to claim incorrectly charged VAT retrospectively. Both the SIFs and their suppliers should review the final versions of the guidelines when they are published (expected in August 2015). It is expected that claims will have to be submitted within either three or six months after the guidelines have been published, depending on whether the claims are made by suppliers or customers.

Denmark – VAT exemption for cost sharing groups is widened

In 1997, the CJEU published a ruling in the *SDC* case (C-2/95). The question referred to the CJEU was whether or not SDC, as a sub-contractor to savings banks, could benefit from the VAT exemption for certain financial transactions. At that time SDC was organised as an association, and the savings banks were the members. The VAT exemption for cost sharing groups was implemented in the Danish VAT Act but not discussed in the case.

SDC and the DTA reached a settlement in Denmark and according to the settlement some of the services were exempt, some were partly exempt, and some were wholly taxable. However, since the settlement, SDC has undergone a re-organisation and is now a Limited Liability Company (LLC).

The DTA have now published an anonymised binding ruling regarding the VAT exemption for cost sharing groups. The facts in the ruling confirm that the taxpayer who is applying for the binding ruling is an LLC and that the services provided to the shareholders are similar to those provided by SDC to its members back in 1997.

The taxpayer has also stated in the ruling request that the LLC does not seek to obtain a profit. Based on this ‘fact’, the DTA have concluded that the LLC is not excluded from the VAT exemption, i.e., the services provided to the shareholders can be exempt.

This ruling widens the scope of the VAT exemption for cost sharing groups and opens up the potential for further outsourcing in the financial sector in general.

France – Car warranties are exempt from VAT

The CJEU has endorsed the Advocate General’s opinion in the French case of *Mapfre Warranty SpA* (C-584/13), about the VAT treatment of second-hand car breakdown warranties. The taxpayer provided a second-hand car breakdown repair service, under which it charged dealers selling the cars a fixed sum and agreed to meet the cost of repairing the vehicles if they broke down during a specified period. It treated the charges to the dealers as subject to VAT.

The French tax authorities took the view that the supplies constituted VAT exempt ‘insurance’ and that the charges made by the taxpayer were subject to French Insurance Premium Tax and not VAT.

The CJEU has now confirmed that the service provided amounts to insurance that is exempt from VAT under EU law. The decision suggests that there might be scope for challenges to the VAT treatment of some warranties currently treated as taxable, in France and elsewhere.

Germany – Draft guidance issued on the purchase of receivables and debt collection

The German VAT legislation includes a rather broad interpretation of the CJEU’s decision in the case of *MKG-Kraftfahrzeuge-Factoring* (C-305/01). According to this interpretation, a purchaser of receivables who collects the receivables in his own name and for his own account, provides a taxable debt collecting service. Accordingly, the purchaser is then regarded as a taxable person and can, subject to the usual conditions, recover the corresponding input tax.

In its judgment in the *GFKL Financial Services* case (C-93/10), the CJEU decided that:

> *an operator who, at his own risk, purchases defaulted debts at a price below their face value does not effect a supply of services for consideration […] and does not carry out an economic activity falling within the scope of the EC VAT Directive when the difference between the face value of those debts and their purchase price reflects the actual economic value of the debts at the time of their assignment*.

In May 2015, the German Tax Authorities (GTA) issued a draft letter to the German Credit Sector associations confirming that an amendment to the German VAT legislation had been proposed. According to the draft version of this new legislation, the operator who, at his own risk, purchases non-performing loans does not provide a taxable debt collection service to the seller, even if the purchaser relieves the seller from the responsibility for the management and collection of the non-performing loans. Additionally, where a portfolio consisting of both performing and non-performing loans is purchased the draft legislation asks for the portfolio to be split between performing and non-performing loans and to the extent the portfolio includes performing loans, the purchaser would continue to supply debt collection services within the scope of VAT.

In summary, therefore, it appears the GTA will limit the applicability of the new case law to non-performing loans and will maintain its former position with regard to performing loans.

Germany – Input tax recovery ‘rounding rule’ referred to CJEU

On 17 March 2015, the German case of *Kreissparkasse Wiedenbrück* (C-186/15) was referred to the CJEU for a preliminary ruling on whether the ‘rounding rule’ in Article 175(1) of the EU VAT Directive must be implemented by Member States where the calculation of the input tax recovery rate is based on calculation methods other than those based on revenue generation. In this particular case, the taxpayer used a specific margin-based methodology. The CJEU will be asked to decide whether the rate of input tax recovery has to be rounded up in favour of the taxpayer regardless of the method of input tax recovery used.

Greece – Instant VAT remittance for bank payments

Pursuant to new law, banks will be required to withhold the VAT amount in respect of payments/ transactions that are mandatorily settled though the bank system (i.e., wholesale transactions of more than EUR 3,000 and retail transactions of more than EUR 1,500) and, principally, through credit or debit cards, e-banking, bank deposit payments of invoices or bank cheques. Certificates will be provided by the bank to taxpayers for reporting purposes.

There are several practical issues that are expected to be clarified through guidance to be issued by the tax authorities. Among them, clarification is required as to how double remittance of VAT (one with the VAT return and one with the bank’s repayment) can be avoided when an invoice is paid in the month following the month of its issuance.

Greece – Increase to Insurance Premium Tax

Insurance Premium Tax was increased with effect from 16 July 2015 on claimable premiums and insurance rights recognised under an Insurance Policy agreement (apart from life and fire insurance).

The applicable tax rates are:

- 20% tax on fire insurance (no change)
- 15% tax on car insurance (up from 10%)
- 4% tax on life insurance (no change)
- 15% tax on all other types of insurance (up from 10%).

The new legislation waives any exemption from Insurance Premium Tax (such as the exemption applying to vessels/ aircraft) except for life insurance exceeding a 10 year duration, for which the exemption remains.

Italy – Clarification of the split payment mechanism

As of 1 January 2015, a split payment mechanism was introduced into Italian VAT law for supplies of goods and services provided to the State and other public entities. Where such supplies are not subject to a reverse charge mechanism, VAT will be payable by the public entities.

The application of this mechanism relies on the ability of the supplier to recognise that it is supplying to a public entity, possibly by using the Index of Public Administrations (IPA), which can be subjective. In respect of this, the tax authorities have issued a circular providing further clarification and stating that suppliers should investigate the legal status of the customer by referring to the applicable legislation and By-Laws and that, where there is uncertainty, they should rely on the indications provided by the customer.

The circular mentions some circumstances under which the 'split payment' does not apply, including but not limited to:

(i) purchases for which the public entity is "liable to pay tax under the provisions relating to value added tax";

(ii) services provided to the Public Administration subject to withholding tax;

(iii) transactions documented by the supplier issuing a tax receipt or a till receipt; and

(iv) transactions subject, for VAT purposes, to special regimes.

Suppliers should not account for output tax indicated on the invoice in the monthly/ quarterly VAT computation, however they will have to enter in the sales ledger the transactions and the related tax not collected from the Public Administration.

Where the applicable invoice does not contain the words "split payment" or "scissione dei pagamenti", the administrative penalty for formal violation is applicable.

Netherlands – Advocate General opinion in *Fiscale eenheid X* (C-595/13)

In the case of *Fiscale eenheid X* (C595/13), the company supplied services to three entities including several pension funds which were involved in purchasing, selling and exploiting real estate properties. The company's services consisted of the management of the real estate and included services such as financial reporting and administration, compliance, selling and purchasing properties and acquiring new investors. The company took the position that all services performed, including the actual fund, asset and property management, fell within the scope of the VAT exemption for management of collective investment funds.

The Advocate General delivered her opinion on the question referred as to whether a fund investing in real estate qualifies as a collective investment fund and if the property management services are covered by the VAT exemption for the management of collective investment funds. In her opinion, a fund investing in real estate qualifies as a collective investment fund and therefore, property management services fall within the scope of the VAT exemption as fund management services.

Regardless of whether the CJEU will follow the reasoning of the Advocate General, the judgment will have consequences for the current Dutch practice, which is inconsistent as rulings have been issued treating these services as both exempt and taxable. As well as clarification on the definition of property management services, the CJEU judgment may also clarify the scope and interpretation of the definition of the ‘management’ of special investment funds.

Sweden – Rules on VAT grouping remain unchanged

During the last year and a half there has been uncertainty as to whether the Swedish rules, allowing companies in the financial sector to form VAT groups, would be abolished or not. This uncertainty occurred due to a change of Government and a rather unusual parliamentary situation following the election. However, the new Government has proposed that there will be no changes to the current rules on VAT grouping in Sweden and the proposal has been accepted by Parliament.

Sweden – *Skandia* principles considered in recent case

On 28 May 2015, the Swedish Supreme Administrative Court (SAC) released its verdict in a case concerning supplies of services from a Norwegian head office to a Swedish branch, included in a Swedish VAT group. In considering the *Skandia* judgment (*Skandia America Corp. (USA)*, C-7/13), the SAC ruled that the supplies were taxable in Sweden and that the Swedish VAT group was liable to pay the VAT

Analysis of the Skandia judgment

In the *Skandia* judgment, the CJEU ruled that the *FCE-bank* principle is not applicable to supplies from an overseas head office to a branch in an EU Member State if the branch is included in a VAT group. As a result, cross border transactions for consideration between establishments of the same legal entity could be subject to tax.

Based on the facts considered in the *Skandia* judgment it was unclear as to whether the CJEU intended that tax should apply to all types of head office to branch supplies, or if the *FCE-bank* principle could still prevail in certain situations. Furthermore, it was unclear what was deemed to be ‘consideration’ for VAT purposes in relation to the transactions between the head office and a branch.

As the *Skandia* judgment concerned an overseas head office's supply of externally purchased services, and as the Skandia branch resold the external services within the VAT group, it has been argued that the principles laid down in the *Skandia* judgment should only be applied in order to prevent tax evasion in relation to international purchasing structures. Moreover, it has been argued that normal cost allocations between two establishments should not be deemed as consideration for VAT purposes.

The SAC's verdict

In its verdict, the SAC disregarded these arguments and ruled that the supply of internally produced services such as management, bookkeeping, IT, etc. should be subject to tax and that the cost allocations detailed in Transfer Pricing documentation should be deemed to be consideration.

The verdict implies a wide-ranging application of the *Skandia* judgment in Sweden. Therefore, as a starting point, the *Skandia* principles could well be applicable to all types of supplies to a Swedish branch, or Swedish head office, included in a Swedish VAT group.

Sweden – Trading in Bitcoins is exempt from VAT

The Advocate General has delivered her opinion in the Swedish case of *David Hedqvist* (C-264/14), about the VAT treatment of exchanging Bitcoins into 'real' currency (Swedish Crowns in the case). The Advocate General concluded that the exchange of a pure form of payment (Bitcoin) for a legal means of payment (a currency which is legal tender) or vice versa is a supply of a service for consideration and the supply is exempt from VAT.

UK – Delay in changes to VAT regulations on input tax recovery

In the March Budget, HM Revenue & Customs (HMRC) announced changes to the VAT regulations that were intended to prevent partly exempt businesses from taking account of supplies made by foreign branches when working out how much of the UK VAT on their overheads can be reclaimed. It was originally announced that the planned changes would take effect from the beginning of the partial exemption year starting on or after 1 August 2015.

HMRC have since announced that they are reviewing the draft regulations in the light of comments made about them and that the effective date for the change is likely to be postponed, perhaps until 1 January 2016.

UK – Summer Finance Bill 2015 to implement tax lock for VAT

The UK Government will set a ceiling for the standard rate and reduced rates of VAT ensuring they cannot rise above their current (2015-16) levels (20% and 5% respectively). The tax lock will also prevent the relevant statutory provisions being used to remove any items from the zero rate of VAT and reduced rate of VAT for the duration of the current Parliament.

UK – Increase in Insurance Premium Tax rate announced

As announced in the Summer Budget, the standard rate of Insurance Premium Tax will increase from 6% to 9.5% on 1 November 2015. In most cases, this cost will be passed through to policyholders, but the transition may be complicated for the purposes of calculating and accounting for the tax for many insurers.

UK – 'Use and enjoyment' provisions to apply to UK repairs made under UK insurance contracts

Also announced in the Summer Budget, the HMRC will start to apply 'use and enjoyment' provisions to UK repair services such that all UK repairs made under UK insurance contracts will be subject to VAT in the UK from 2016. This change will seek to counter those arrangements where claims fulfilment services are characterised as being made to an offshore insurer under indemnity in kind contracts, rather than to the insured. The intent of these arrangements is that no UK VAT is charged on the fulfilment services. Such arrangements have, to date, been dependent on identifying to which party the supply of fulfilment services is made. Depending on the precise changes, this distinction will likely become redundant so that, irrespective of the identity of the recipient of the supply, such services will be subject to UK VAT.

UK – Review of off-shore based avoidance in exempt sectors

Finally, in relation to VAT, the Summer Budget announced a review of off-shore based avoidance in VAT exempt sectors with a view to introducing 'use and enjoyment' provisions for services such as advertising in 2017. Again, this may bring these services within the scope of UK VAT where, to date, they may have been provided to overseas financial services businesses VAT-free.

This is almost certainly a reaction to the outcome in the *Ocean Finance* case (C-653/11), in which the Upper Tax Tribunal concluded that the taxpayer had been successful in implementing a VAT mitigation arrangement (involving UK advertising costs).

The key questions here will be how ‘avoidance’ is defined in the changes, whether HMRC will further define the concept of ‘use and enjoyment’ in the UK, which has always been difficult to ascertain, and the extent to which the changes are applied to services other than advertising.

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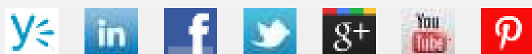

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