Input VAT newsletter

EU financial and insurance services VAT review: Results of public consultation

7 October 2021

During the summer 2021, the European Commission published the results of its public consultation on the VAT rules in the financial and insurance services industries, which was held from 8 February to 3 May 2021. The publication of the results is an important step as the Commission has stated that “the answers provided will feed into the review of the relevant provisions of the VAT Directive (Council Directive 2006/112/EC) and will contribute to a possible future legislative proposal.” The numerous answers and comments that were received provide some interesting insights that are worth exploring.

This newsletter complements the one issued in February 2021 and an integrated version may be found at this link. We plan to issue additional newsletters as appropriate based on how the review process evolves.

The respondents

The questionnaire prepared by the Commission included 63 questions and the answers of the 469 respondents are summarized in a 230-page Excel document. However, the Commission considers that 271 respondents (58%) were part of a “campaign” from Austria (based on the similarity of the answers, the wording used in answers to open questions, and the excessive number of respondents (around three-fifths) identifying themselves as Austrian). However, we should keep in mind that these 271 respondents all strongly supported VAT exemptions and believe they should be extended to services such as individual asset management and advice, leasing, or crypto-assets, etc., which, as we will see, is consistent with other answers to the survey. Nonetheless, even after excluding the answers from this “campaign,” Austria was still the most represented country (47 answers), followed by Germany (44 answers).

This discussion focuses on the remaining 198 answers. It is also based on 51 additional documents (around 300 pages) from 35 business associations and 11 companies, as well as the Commission’s “factual summary report” (38 pages).

It is interesting to mention that the respondents included 86 companies, including some large and international ones, as well as some smaller and more local ones, and 73 professional associations, whether European or national. In the case of Luxembourg, the associations included the Luxembourg Bankers’ Association (ABBL), the Association of the Luxembourg Fund Industry (ALFI), whose comments, at 14 pages, are the longest, and the Luxembourg Private Equity & Venture Capital Association (LPEA). Deloitte also provided a document analyzing general issues based on the daily experiences of practitioners in its financial services industry/VAT network (The Future of VAT in Financial Services and Insurance | Deloitte Netherlands).
Each of the three major financial services sectors—banks, insurance companies, and funds—were represented in a balanced way in the results, in contrast to “innovative services” such as “crowdfunding,” which were almost absent. These sectors provide services to all types of customers (individuals, businesses, etc.). Less than 20% operate either in the EU or outside of the EU while the remaining 80% are divided more or less equally between those operating only nationally and those operating across the EU.

**Exempt or not, that is the first question**

The first question was whether the VAT exemption for financial and insurance services should be maintained.

The answers to this question are clear: around 75% of respondents support exemptions, including around 60% who “strongly” support them. This seems based on the view that exemptions work “well” or “very well” according to around 43% and around 17% of respondents, respectively, even if they are not perfect. While around 30% find that their functioning is poor and could be improved.

*Figure 1: whether or not the VAT exemption for financial and insurance services should be maintained?*

These observations must be nuanced, however, by the fact that around 70% of respondents think that exemptions are no longer adapted to recent developments, such as the digitalization of the economy. This last statement could be surprising because the Court of Justice of the European Union (CJEU) decided as early as 1997 in its SDC decision (C-2/95, 5 June 1997) that the fact that a service is delivered electronically should not prevent the application of the exemptions, a principle that the Court has repeated on numerous occasions. However, it is true that the application of even a simple principle is not always easy in practice, as the respondents’ answer seems to confirm. According to the respondents, the difficulties are mainly due to a lack of clarity and the complexity of the concepts more so than differences between EU member states, even though about two-thirds of the respondents consider that these difficulties have a negative impact on the development of cross-border services.

Despite the nuance about lack of adaptation to recent developments, the results of the public consultation seem quite clear.
What solutions?

Among the different solutions theoretically possible, there are four “global” ones and four “technical” ones, which we examined in more detail in our February newsletter. The global solutions include taxation at the standard rate, taxation at a reduced rate, a zero rate, and an option to tax. The technical solutions include the use of a VAT group, the use of an independent group of persons (IGP)/cost sharing agreement (CSA), a fixed VAT deduction rate, and revised exemptions.

Global solutions

Around 9% of respondents support taxation at the standard rate for all or only fee-based services while around 15% support taxation at a reduced rate for these services. The standard rate solution finds support mainly in a handful of companies active in industrial and commercial activities (which generally are entitled to a full VAT deduction) and their associations. These companies also support the reduced rate solution, joined by a limited number of companies and associations in the financial and insurance sectors facing specific issues, as further discussed below.

Out of 51 respondents, 18 which have provided additional documents mention the zero-rate solution (which amounts to an exemption with the right to deduct VAT on costs). This shows some appetite for this solution and indicates its appeal even though this mechanism is not very well known in the EU and was not included in the Commission’s questionnaire.

Many participants, around 75%, consider the “option to tax” solution one of the most effective possible reforms. To the question whether the option should remain at the discretion of each member state, as is currently the case, around 65% would like it to be available in all member states. Even if the questionnaire does not address this specific point, it would seem appropriate to introduce harmonized rules should the option become mandatory in all member states. Various comments confirm this point.

Technical solutions

The different technical solutions received a lot of support. This is not surprising because only full taxation would make them useless which, as mentioned above, is not the wish of most respondents.

Both the IGP/CSA solution, whose use by the financial sector was denied in 2017 by the CJEU (DNB Banka AS, C-326/15 and Aviva, C-605/15, 21 September 2017), and the VAT group solution received clear support. Indeed, the IGP/CSA solution has 134 supporters against 9 opposed and 55 with no answer or no opinion. A similar number supports applying this solution on a cross-border basis. Results are roughly similar for the VAT group solution.
As a reminder, the VAT directive requires member states to make IGPs/CSAs available, which is why this mechanism is available in all jurisdictions. On the contrary, making the VAT group mechanism available is not mandatory. As a result, this mechanism is not available in all member states even if, after the CJEU decisions mentioned above, some member states have (e.g., Luxembourg in 2018) or will (e.g., France in 2023) implement the VAT group mechanism in their legislation. We may have expected this difference of experience to influence the answers as people usually more strongly support what they are used to. This does not seem to be the case, however. Instead, the results seem to indicate that the respondents think that these two tools could be useful in achieving a common objective, i.e., managing shared services, even if they present different technical features. In addition, a large majority of respondents want these two regimes to apply cross border in the future, which would mean harmonizing the rules, even if this question was not specifically addressed.

Interestingly, a fixed deduction rate is supported by around 30% of respondents compared to around 45% who oppose it and a large balance with no opinion. We could consider this a fairly good score since this mechanism is unknown in the EU even though it is practiced, for example, in Australia.

An overwhelming majority of respondents to this question, around 80%, is in favor of the mechanism’s optional nature. Indeed, its impact depends on the rate applied. If the rate is significantly lower than that enjoyed by taxable persons under the current rules, the
mechanism may be lose its appeal, apart from administrative simplification, which is probably relatively limited.

Finally, a large majority considers that it is necessary to update the VAT exemptions if they are maintained, which is also largely supported. More than 90% of respondents feel that this update should be based on CJEU case law. This may seem a little surprising because this jurisprudence is supposed to be binding on the member states and thus should already be part of their national law. However, this may reflect the fact that participants consider that some member states do not properly take this jurisprudence into account in local legislation. The remaining minority considers that the update should be based on the EU regulations applicable to financial and insurance services. The CJEU already partially achieved this result for fund management services, finding that these services include “at least” those listed in Annex II of the **UCITS Directive 85/611** (*Abbey National*, C-169/04, 4 May 2006). By contrast, the Court developed its own definition of insurance operations separate from that of the directive (*CPP*, C-349/96 25 February 1999) and clearly excluded the link between the tax and legal definitions, as confirmed, for example, in the *United Biscuits* case (C-235/19, 8 October 2020). It is true that this reference to other (non-VAT) EU legislation, *a priori* attractive in its simplicity, has the disadvantage of being dependent on tax legislation, which must be adopted unanimously by all member states, as opposed to legislation that is adopted by majority vote. In any case, it seems clear that respondents think that the rules exempting outsourced services from VAT should be clarified and harmonized.

**Analysis by sector**

Beyond the responses to the questionnaire, respondents had the opportunity to provide comments to clarify their positions or highlight additional issues. In all, 51 participants used this opportunity, which allows a sectoral analysis.

**Asset management: Investment and pension funds**

The analysis for the asset management sector is primarily based on the 14-pages ALFI document, which is essentially similar to the one from its European umbrella organization, the European Fund and Asset Management Association (EFAMA), but also those from other national associations. The fund industry insists on the positive social and economic impacts of the VAT exemption applicable to investment fund management services. This exemption facilitates investment by preventing an additional tax burden, a policy reason that the CJEU highlighted in the *Abbey National* case. Consequently, subjecting management services to VAT when the ultimate investors are individuals, directly or indirectly (via insurance products or pension funds), could be detrimental. It would risk reducing these individuals’ investment capacity, diverting them from fund investments to less productive ones, or leading them to invest in funds outside of the EU, which would have a negative impact on the level of investment. The associations representing pension funds are fully in line with these various considerations.

**Private equity**

Given that private equity is another facet of asset management, although it has different modalities, it is not surprising that the associations that have submitted comments (InvestEurope and LPEA) are in line with the fund sector.
Insurance

Although the insurance sector as a whole is also in favor of maintaining the VAT exemption for quite similar social and economic reasons, its position is actually influenced by the tax on insurance (IPT). While this tax goes relatively unnoticed in Luxembourg because its rates are rather low (4% and 6%), this is not the case in other countries such as Germany, Finland, or France where the rates may be equivalent to those for VAT, i.e., 19%, 20%, or 24% on some or all insurance products. It should be remembered that, in addition to the IPT, which is not deductible, there is a “hidden VAT” that the provider, in this case the insurance company, bears on its costs.

Because of this very high tax burden, even taxation at the standard rate would be preferable for insurance companies. Indeed, in all cases, the hidden VAT would disappear. The replacement of the IPT with VAT at the same rate would be neutral for individuals and other taxpayers that cannot deduct VAT while it would be favorable for businesses which, generally, can deduct VAT on their costs. However, as mentioned above, not all member states are affected equally by this situation. This is reflected in the comments of some national associations while the position of Insurance Europe, the European umbrella organization for insurance associations, is in favor of the exemption, even if it should be improved such as by introducing an option to tax.

Banking

Compared to the sectors discussed above, the banking sector has many different features. The first is the diversity of its services and products, which may include asset management services or the distribution of funds or insurance products whereas the previously discussed sectors primarily offer a single product. Another factor of diversity is the coexistence of services remunerated by commissions and so-called “margin” services, such as the granting of credit or purchases of foreign currency or securities. It may be difficult to determine the tax base for these services in the event that they become taxable: should the entire amount of the credit or sale be taken into account or only the margin on the assumption that the bank does not act as an intermediary? In addition, all types of consumers receive banking services whereas fund management services are primarily aimed at private investors and, in general, investment and private equity funds are final consumers since they cannot deduct VAT on their charges.

As a result, a large majority of respondents from the banking sector support the VAT exemption, including the sector’s European umbrella association, the European Banking Federation (EBF), with some providing a neutral response or no response. However, there were a few minority voices in favor of abolishing the exemptions (one bank, one payment service provider, and two associations). These reflect the specific concerns of payment service providers, which have to pay large amounts of VAT on important investments, such as information technology.

Consumers

Commercial and industrial companies consuming services expressed themselves as well, mainly through their European association, BusinessEurope. To the extent that these companies can fully deduct VAT, they are affected by the “hidden VAT.” Therefore, a reform leading to the taxation of financial services would seem appropriate. Nevertheless, these participants generally provided a “neutral” response when asked if the exemption should be maintained. Indeed, these respondents are conscious of the potential impact of full taxation at the standard rate for those that cannot deduct VAT (mainly individuals) and their comments take this issue into account. Therefore, they suggest that solutions such as a
reduced rate, an option to tax, or even a zero rate (exemption with the right to deduct) should be explored in greater depth.

Only one association, from the Czech Republic, and 30 “citizens” represented private consumers. An overwhelming majority (around 85%) of these respondents is in favor of the exemptions and a slight majority considers that they work well or very well.

And in Luxembourg?

Finally, it should be noted that the Luxembourg associations that participated in the consultation, ABBL, ACA, ALFI, and LPEA, are unanimous in their “strong” support for the exemptions, even if there are nuances in their answers regarding the types of problems that derive from the exemptions, their respective acuteness, and proposed solutions. This should help the Luxembourg authorities in their assessment of the situation and the economic impact of the future legislative proposal, which, after its preparation by the EU Commission, will have to be discussed among, and approved unanimously by, the 27 member states.

Comments

Both the quantitative and the sectoral analyses indicate a general and clear support for the VAT exemptions with a need for improvements such as updated definitions, more efficient VAT group and IGP mechanisms, or even, to meet the expectations of businesses, the elimination of the “hidden VAT,” the generalization of the option to tax, or a zero rate.

The next step in this long process should be the publication of the Commission’s impact assessment and synopsis report based, inter alia, on the results of the consultation, but also a preliminary study carried out by a consortium of external consultants, the Commission’s own research, and discussions with various affected parties.
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