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European Commission review of the VAT rules for financial and insurance services

Why? Main issues? Possible solutions?

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On February 8, 2021, the EU Commission launched a public consultation on its review of VAT exemptions applicable to financial and insurance services. This consultation is part of a process set to take place throughout 2021 that should culminate in the Commission's presentation of a draft legislative text amending the current EU VAT Directive by the end of the year. The ball will then be in the court of the EU Council of Ministers, the EU Parliament and the member states. Of course, any change in VAT matters must be decided unanimously by the 27 member states, and adoption of the new rules may therefore be a long process. Stakeholders will want to keep a close eye on this process and may wish to participate in the debate.

The EU review VAT on financial and insurance services started in 2019 with a report conducted by a consortium of researchers appointed by the EU Commission (the "Report"). The aim of the Report was to investigate the issues caused by VAT exemptions and the possible solutions. The report included around 185 interviews with VAT administrations, businesses, and professional associations. The Commission then published a roadmap in October 2020, to which more than 20 professional associations responded. According to the Commission timetable, the next steps should be a conference in spring, the publication of an impact assessment around mid-year, and a draft legislative proposal towards the year-end.

The aim of this special edition of our "Input" VAT newsletter is to provide stakeholders with some high-level information to guide them through this process, which has particular relevance for financial services providers and insurance companies, and for Luxembourg's financial industry as a whole. The public consultation (VAT rules for financial and insurance services – review (europa.eu) is open until May 3, 2021 (midnight Brussels time), and we hope that this newsletter might be of interest to stakeholders keen to play a part in this important process. This document does not claim to address all issues, impacts, and solutions, but sets out what we believe to be the most relevant factors.

As always, the Deloitte Luxembourg indirect tax team is on hand to discuss the potential impacts of this decision for your organization at your convenience.

Raphaël Glohr , Partner
Michel Lambion, Managing Director

HISTORICAL

BACKGROUND

1. Historical background

We are so used to living in a world where most financial (including fund management) and insurance services are VAT exempt that we may not be aware of the reasons behind the exemptions.

It is worth remembering that VAT is essentially intended to apply as broadly as possible to all economic activities (with only the end consumer paying the tax—mainly individuals, but also NGOs and public bodies), and to be neutral for businesses.

Although the EU VAT Directive was adopted a long time ago, in 1977, it is interesting to look back and examine the main reasons why these services continue to be VAT exempt, because this highlights the rationale for the review and the difficulties it raises.

First, some of the exempt services were already subject to other taxes, and member states did not want to lose the related tax receipts. Such taxes included, for example, insurance premium taxes or the French "taxe de bourse" applicable to most financial services. Some of these taxes still exist. The most well-known and applicable in many, although not all member states, is insurance premium tax, the rates vary significantly and can be as high as 30% in France[1] for example. Member states did not want these taxes replaced by VAT because they apply to businesses as well as individuals, whereas VAT is—in principle—neutral for businesses. In other words, member states would have to meet tax reclaims from businesses for VAT paid on financial and insurance services, while they do not have not to refund the other taxes. Replacing these taxes with VAT would therefore have meant a reduction in tax receipts.

Second, it is politically difficult to apply VAT to financial and insurance services, particularly to interest on loans. This was especially the case when interest rates were much higher than they are now: in 1980, for example, the Fed funds rate was 20%[2]. With today's consistently low or even negative rates, it's easy to forget that our (grand) parents paid 15-20% on their 70s and 80s mortgages.

More recently, Greece also faced interest rates of 20%[3] during the 2010-11 financial crisis, while it now benefits from rates of around 1%. Paying 20% VAT on an interest rate of 1% or 2% might be affordable, but with interest rates in the region of 20%, it could prove prohibitive.

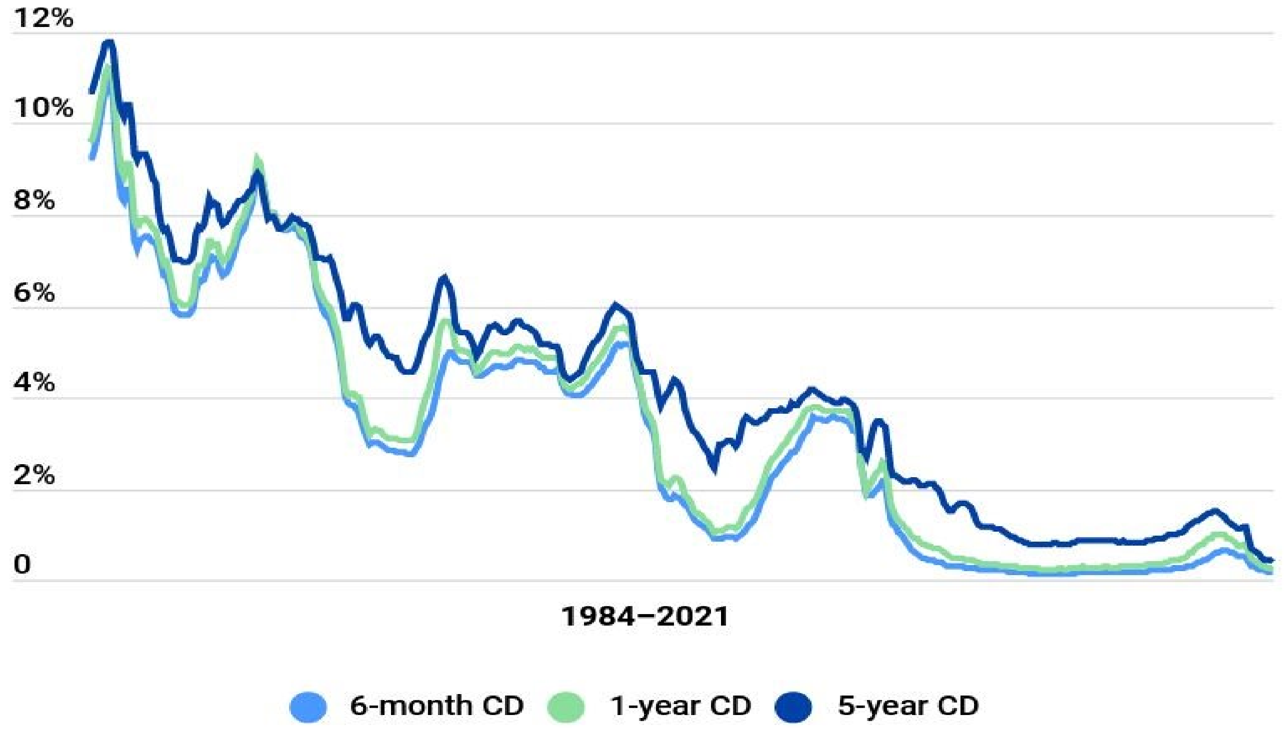
The table below shows the level of interest rates in the period 1984-2021[4]:

[1]While insurance premium tax is relatively low in Luxembourg (4% or 6%, with an exemption for life insurance products), it can be substantially higher in other countries: 12% or 20% in the UK (https://www.gov.uk/guidance/insurance-premium-tax); 9.25% in Belgium (main rate) (https://finances.belgium.be/fr/search?keywords=taux+de+la+taxe+annuelle+sur+les+op%C3%A9rations+d%27assurance&=Zoek;), 7% to 30 % in France (https://www.economie.gouv.fr/particuliers/taxe-sur-conventions-assurances).

[2]https://www.pbs.org/newshour/economy/what-led-to-the-high-interest

[3] In this document, we will use the 20% as it is close to the EU average VAT rate and made examples more clear.

[4]https://www.bankrate.com/banking/cds/historical-cd-interest-rates/



It is clear that applying 20% VAT on an interest rate of 15% or 20% per year would have substantial social, economic and political impacts—especially with inflation also a major concern at that time. How many people would be willing or able to pay VAT on top of such high interest rates?

Similarly, the VAT exemption for management services relating to investment funds (including pension funds) was justified by the aim of encouraging long-term savings and investments. This is extremely important when Europe is facing a pension savings gap of €2 trillion[5].

Third, it is difficult to assess the taxable basis when the remuneration of services is margin-based (rather than fee-based), which is often the case for financial services such as the provision of loans, currency transactions, etc., while high frequency trades such as stock market transactions are also problematic.

Lastly, when the directive was adopted, the financial industry was much more national than cross-border, and less complex in terms of products, outsourcing of activities, etc. Recent developments have therefore added to the issues caused by VAT exemptions.

[5]"*Mind the Gap - Quantifying the pension savings gap in Europe*" – Aviva, September 2016

ISSUES CAUSED BY **VAT EXEMPTIONS**

2.Issues caused by VAT exemptions

a. Hidden VAT

As already mentioned, VAT is a consumption tax that should be paid only by end consumers, i.e. individuals plus all other entities that do not perform economic activities (e.g. public bodies, NGO, etc.). These end consumers cannot deduct VAT on their costs. On the other hand, economic operators (businesses) should not be affected by VAT, because they can deduct VAT on their costs. This is the concept of "tax neutrality".

However, when a supply of services is VAT exempt, the supplying business cannot deduct the VAT it has incurred. It will therefore take into account this non-deductible VAT when calculating its sale price, and will pass on (or try to pass on) this cost to its clients. While this is favorable for individuals and other entities that cannot deduct VAT, it is unfavorable for businesses that can deduct VAT, because the non-deductible VAT is passed on to them, increasing their purchase price. This VAT is often referred to as "hidden" or "embedded" VAT. This reminds us that generally businesses pass on, or try to pass on, to their clients any indirect tax that is imposed to them, as it is a cost of business for them.

For example:

A business has costs subject to VAT of 40, it pays salaries of 40 and wants to make a gain of 20. It has clients that can deduct VAT and clients that cannot. For the sake of simplicity, we assume a VAT rate of 20%.

	Client that cannot recover VAT (individuals, NGOs, public bodies)	Client that can recover VAT (businesses)
Exemption	108 (1)	108 (1)
Taxation at standard rate	120 (2)	100 (3)

1. 40 + 40 + 20 + 8 of non-deductible VAT = **108**
2. 40 + 40 + 20 + 20 of VAT = **120**
3. 40 + 40 + 20 + (20 - 20 of VAT deductible by the client) = **100**

This simple example illustrates that a private client would favor an exempt supply, while a business client that can deduct VAT would prefer a supply subject to VAT.

b. Outdated and imprecise definitions and lack of harmonized interpretation

Since the EU VAT Directive was adopted in 1977, the definitions of VAT exemptions have remained unchanged, while the financial and insurance industries have dramatically evolved, leading to the emergence of ever more complex and international products, businesses, and markets.

Moreover, these definitions are very general and imprecise. For example, the Directive states that "*transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities*" are VAT exempt, but without providing a definition of these transactions or any of the related concepts. Moreover, EU VAT legislation as a whole does not provide any more detailed definitions, i.e. there are no EU regulations or any legally binding guidelines. As such, member states often have different interpretations of these exemptions.

This has led to a large body of case law being generated at the Court of Justice of the European Union (CJEU), which nonetheless has not addressed or solved all of the issues concerned. Moreover, the interpretations and application vary from one member state to another.

As might be expected, this has created legal uncertainties and hampered application, especially in cross-border situations, inter alia, distorting competition between member states.

c. Outsourcing

As mentioned above, with the exemptions in place, the providers of financial and insurance services cannot recover VAT on their costs.

This is true for all costs. However, the fact that more and more providers outsource some activities or functions has increased the impact of the non-deduction. In this respect, it is worth noting that the CJEU case law has opened up the possibility of exempting outsourced services if certain conditions are met. For example, outsourced fund management services would qualify for the VAT exemption if they, in the words of the CJEU, constitute a "distinct whole" necessary for the supply of an exempt service.

It is easy to see that such a concept could be interpreted and applied in very different ways, leading to the issues we have mentioned regarding outdated definitions: legal uncertainties, difficulties of application especially in cross-border situations, distortion of competition between member states, etc.

With the cross-border delegation of services and in/outsourcing becoming increasingly common, this is a much more important issue than in the past, when transactions were performed mainly in-house and at national level.

d. Calculation of the VAT deduction entitlement

Often, financial and insurance industry operators principally perform services that do not give rise to the right to deduct VAT, together with some services where there is a right to deduct[6]. They must calculate their VAT deduction entitlement in accordance with rules that can be complex, and which vary from one member state to another. This is an additional difficulty, as well as an administrative burden.

Other issues, such as the difficulties involved in adopt a VAT group or independent group of persons regime, are discussed below. If these regimes are improved, they may also be possible solutions.

[6]Services that give rise to the right to deduct VAT are, on the one hand, taxable services such as the safekeeping of shares, the rental of safe deposit boxes, private wealth management services, etc. and, on the other hand, financial and insurance services provided to clients established or domiciled outside the EU or relating to goods that are exported outside the EU.

POSSIBLE
SOLUTIONS

3. Possible solutions

Below, we list some potential solutions, from the more general and radical, to more specific and "traditional" alternatives. It is possible that a combination of some of these solutions could be envisaged. We also provide comments, which refer to presentations of the Report during the VAT Expert Group meeting on 25 May 2020 and Group on the future of VAT [7] meeting on 28 May 2020[8]. Our comments are not intended to be interpreted as supporting one solution or another.

a. Taxation at standard VAT rates

Taxation at the standard VAT rate for services that are currently exempt is clearly the most radical solution. It should be noted that some countries tax all or at least some financial services. However, VAT rates are generally lower outside the EU.

This solution would be likely to have the following impacts:

1. An increase in government VAT receipts
2. A decrease in demand for financial services

Interestingly enough, the Report conducted for the European Commission provides estimates of €62.5 billion for the increase in government VAT receipts, and €38 billion for the decrease in demand for financial services.

3. Individuals and other entities that cannot deduct VAT (public bodies, NGOs) would probably be negatively affected, because the overall price of services would most likely increase.
4. Businesses that purchase financial service should benefit from the disappearance of hidden VAT, and a decrease in the price of services. This would be the case if the service providers pass on the VAT that becomes deductible to their clients. It would also be possible for VAT savings to be shared between service providers and clients.
5. Member states applying the lowest standard VAT rates would have a competitive advantage. Standard rates range from 17% to 27% in the EU, with an average of around 21%. For example, standard rates are 17% in Luxembourg, 19% in Germany, 20% in Austria and France, 21% in the Netherlands and Spain, 22% in Italy, 23% in Ireland and Portugal, 25% in Denmark and Sweden, and 27% in Hungary etc.
6. A risk of the delocalization of financial activities, which has been increased by the availability of online services: fintech is the most obvious example but not the only one. On this point, the UK government confirmed in December 2020 that all exempt financial services would give the service provider the right to deduct VAT on its costs when its client is established outside the UK, except for fund management services, which are subject to special rules which are currently under review[9]. In other words, a UK bank granting a loan to a EU client would have a lower cost base than its EU competitor. We should also mention that financial centers are established in countries where no VAT applies to financial services and/or where VAT rates are generally very low (Hong Kong, Singapore, Channel Islands. Switzerland, USA, etc.).
7. The issue of the outdated and imprecise definitions would be removed.
8. Issues such as VAT on outsourcing and the non-harmonized application of VAT rules by member states would be solved.

b.Taxation at a reduced rate

The application of a reduced rate, for example 5%, may solve other issues, such as hidden VAT for businesses, without impacting private clients too negatively. This would hopefully avoid the risk of delocalization. For example, China applies a reduced rate of 6% to financial services, while its standard VAT rate is 13%.

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[7] The VEG and GFV are two consultative bodies with the EU Commission composed respectively of some independent VAT experts and representatives of the national VAT authorities of the 27 Member States.

[8] The Report is currently not published. However, the consultants conducting the Report have presented extracts of the draft during the VEG and GFV meetings of 25 and 28 May 2020. We refer thus to these presentations.

[9] Under the UK's current VAT law, fund management services are VAT exempt and do not give the service provider the right to deduct VAT when these services are rendered to some categories of UK funds and to foreign funds distributed in the UK. When these services are provided to foreign funds not distributed in the UK, which is the most common case, they do give rise to the right to deduct VAT.

	Client that cannot recover VAT (individual, NGO, public body)	Client that can recover VAT (business)
Exemption	108 (1)	108 (1)
Taxation at standard rate	120 (2)	100 (3)
Taxation at reduced rate	105 (4)	100

A business has costs subject to VAT of 40, it pays salaries of 40 and wants to make a gain of 20. It has both clients that can deduct VAT and clients that cannot. For the sake of simplicity, we assume a standard VAT rate of 20% and a reduced rate of 5%.

1. 40 + 40 + 20 + 8 of non-deductible VAT = 108
2. 40 + 40 + 20 + 20 of VAT= 120
3. 40 + 40 + 20 + 5 or 20 of VAT deductible by the client = 100
4. 40 + 40 + 20 + 5 = 105

This example clearly indicates what the impact of a reduced VAT rate might be. It should not, however, be assumed that a reduced VAT rate would in all cases be less costly for clients that cannot recover VAT. An example with a higher reduced rate (or a service provider with lower costs) would have implied an increase of the price for such clients.

The above-mentioned Report indicates an increase of €3.8 billion in VAT receipts and a decrease of €0.7 in demand should a reduced rate be applied on financial (but not insurance) services. Although the reduced rate assumed in the report is not disclosed, it appears to be slightly higher than the one we used for the example above, as well as the 3% “super-reduced” rate applied by Luxembourg.

However, issues around the stability of the rate over time should also be taken into account, as well as the question of whether a single reduced rate would apply in all EU member states, or if different reduced rates could be adopted, possibly within a range established at EU level. In this respect, it should be noted that at present, reduced VAT rates vary from 2.1% in France and 3% in Luxembourg (“super-reduced” rates) to 18% in Hungary (i.e. higher than the Luxembourg standard rate) and that some member states, including Luxembourg, have two or three reduced rates. If member states apply VAT rates that are significantly different, those applying the lowest ones might have an advantage, as is the case with standard rates.

Another positive impact would be that issues such as VAT on outsourcing or the difficulty of calculating the VAT deduction entitlement would be solved. On the other hand, the issue of the outdated and imprecise definitions would remain, because it would still be necessary to draw the line between services subject to the standard VAT rate and those benefitting from the reduced rate. Similarly, this would not solve the issue regarding the taxable basis of margin products or the difficulties of taxing high frequency trading.

c. Zero rate

The zero rate could be classified as a “super” (or) “turbo” exemption. Under this mechanism, suppliers would not charge their clients any VAT, while being able to deduct VAT on their costs. A zero VAT system already applies, for example, to newspapers in Belgium, and to a wide range of goods and services in the UK that are considered essential or supplied to charities. With reference to our previous example, all clients would pay the same price, 100, and the service provider would be relieved of the VAT on its costs.

It is worth noting that the Report rules out this solution. Although it is not stated explicitly, it is reasonable to suppose that this is because of the likely impact on VAT receipts. However, zero VAT solves almost all the issues mentioned above, except for the definitions, because it would still be necessary to differentiate between taxable services and those that might benefit from zero rating.

Another important factor is international competiveness. As stated earlier, the UK government confirmed in December 2020 that providers of exempt financial services (except for fund management services which are subject to special rules) will be entitled to deduct VAT on their costs when a client is established outside the EU. Accordingly, a UK bank providing a loan to a EU client would have a lower cost base than its EU competitor.

In this respect, it is worth noting that the cost of this measure was evaluated by the UK chancellor to be £800 million per year. This is certainly not a negligible sum. Given the respective sizes of the EU and UK financial industries, the cost in the EU would probably be higher should a similar measure be implemented. However, it would likely be much lower than the amount of additional VAT receipts, which at the standard rate, was estimated by the Report at €62.5 billion (see above, under a), since the VAT on costs should be lower that the VAT on income due to the nature of VAT, which is to tax consumption.

d. Option to tax

The EU VAT Directive allows member states to introduce an “option to tax” for real estate and financial services (including fund management services), but not insurance services[10]. However, the Directive provides no details on how it should be used. Member states therefore have full discretion on implementation. For example, the option to tax could be introduced for certain service categories (e.g. in Belgium, it only applies to payment services) or for all services. Another possibility is that the option could be selected for all clients (as in Belgium), or

[10] The option is not available for insurance services, probably because these are generally subject to insurance premium taxes.

on a client-by-client, or even service-by-service basis (as in Germany). It appears that some member states, notably Belgium, France, and Germany, have introduced the option to tax for financial services. Germany's rules apparently offer the most flexibility, and German banks are increasingly opting in.

Assuming that an option to tax could be exercised on a client-by-client basis (i.e. only for clients that can deduct VAT):

1. The issue of hidden VAT could be solved for businesses, without entailing a price increase for clients that cannot deduct VAT.
2. There should not be a risk of delocalization. In fact, since service providers' costs would decrease when they provide services to entities than can deduct VAT—without increasing the costs for clients that cannot deduct VAT—it could be considered that an option to tax would level the playing field with service providers established outside the EU.
3. An option to tax should partly solve issues such as outsourcing. For example, a bank whose VAT deduction entitlement increases from 20% to 60% when it exercises the option to tax would be able to deduct 60% on the outsourced services instead of 20%. The VAT burden on outsourcing would thus be reduced, but not removed (except in the unlikely event where the option is exercised for all services because all clients are able to deduct VAT).
4. The definitions issue would not be solved. It would still be necessary to be able to distinguish between services that are always taxable and those that could remain VAT exempt if the option to tax is not exercised, since service providers would have to determine the impact on their clients and on their own VAT position (VAT deduction entitlement).
5. Some practical difficulties may arise, for example, in terms of identifying whether clients can or cannot deduct VAT.
6. An option to tax on a client-by-client basis would not remove the difficulty of determining the taxable basis of margin-based products, nor the practical aspects related to high frequency trading.

Alternatively, an option to tax that must be exercised for all clients would have the following consequences:

1. The hidden VAT issue for clients that can deduct VAT would be solved. However, it would imply a price increase for clients that cannot deduct VAT.
2. Issues such as outsourcing would be solved.
3. The definitions issue would not be solved. It would still be necessary to be able to distinguish between services that are always taxable and those that could remain VAT exempt if the option is not exercised, since service providers will have to determine the impact of the option on their clients and on their own VAT position (VAT deduction entitlement).
4. Some practical difficulties may arise, such as IT implementation, but would probably be less burdensome than in the case of the option to tax on a client-by-client basis.
5. An option to tax that must be applied to all clients would not remove the difficulty of determining the taxable basis of margin-based products, nor the practical aspects linked to high frequency trading.

e. Revamped definitions

One of the most obvious solutions would be the implementation of new definitions. We note, however, that an EU Commission review of the definitions was launched in 2007, but shelved in 2016 having proved impossible for member states to agree, particularly with regard to outsourcing and whether the fund management exemption should be limited to retail investment funds or also be available for more specialized or reserved funds.

More precise, harmonized, and modern definitions would improve the legal certainty and level the playing field between member states. But it would not solve the other issues, such as hidden VAT, the VAT on outsourcing, or the difficulty of determining the taxable basis of margin-based services, etc. It would thus be necessary to combine the revamped definitions with other solutions. Even so, new definitions would be ineffective in the case of taxation at the standard rate, and would only improve the situation if a reduced rate or zero rate is applied, or if the option to tax must be exercised for all clients. From a practical viewpoint, it might be helpful to align the VAT definitions with those adopted in other EU legislation applicable to banking, fund management, and insurance.

f. VAT groups

A VAT group enables a number of different companies to be considered as a single taxable person, provided they have close financial, economic, and organizational links. In a VAT group, all supplies between members are disregarded for VAT purposes, i.e. they are treated as internal transactions. To some extent, VAT groups may be compared to the consolidation process in accounting.

Aside from the close links criterion, under current EU rules member states have considerable discretion in how they implement the VAT group regime in their national laws. For example, some member states have made forming a VAT group mandatory if the conditions are met, although this is optional in most member states. Another important factor is that some member states limit the benefits of the VAT group regime to certain sectors of activity.

At present, VAT groups are allowed in more than 20 member states, but with very different rules. The VAT group has nonetheless proved to be an efficient and useful tool for many years in countries such as the Netherlands and the UK, and more recently in Belgium (2007) and Luxembourg (2018), and there are plans to introduce it in France in 2023.

The main advantage of VAT groups for the financial services sector would be to avoid the VAT on services rendered between members, especially in relation to shared services such as IT, internal administration, etc. For example, a banking group would be able to centralize all its IT functions in one dedicated entity that can provide services to all group members without charging VAT.

The advantage of the VAT group would be limited to removing VAT on "internal services" (insourcing); it would not solve any of the other issues identified. It would therefore be necessary to combine it with other solutions. On the other hand, solutions involving taxation at a standard or reduced rate would make it less effective, because its main advantage (avoiding VAT on internal supplies) would no longer be relevant, while the other advantages of the VAT group linked to administrative simplification are less significant.

Currently, a key issue with VAT groups is that they only work on a national basis, i.e. a VAT group can only include members established in the same member state. One improvement would therefore be to make VAT groups possible on a cross-border basis. Such a move would require member states to introduce the VAT group in their national legislations, and the criteria for application would have to be harmonized[11], to prevent member states from applying the regime in a manner that gains them a competitive advantage.

g. Independent group of persons

The independent group of persons (IGP) (or "cost sharing association") permits a VAT exemption for services that are "directly necessary" to the activities of their members. The CJEU decided in 2017 that this regime could be used only by "persons" performing activities in the public interest (e.g. hospitals). Before this decision, the IGP regime was used extensively by the financial and insurance sectors, including on a cross-border basis, proving, without any doubt, its relevance for the sectors concerned. For example, a banking or insurance group set up an entity under this IGP regime to provide IT services to all group companies without having to charge VAT.

At first glance, the IGP regime could be seen as an alternative to the VAT group. This is partially true. However, the following factors should be taken into account:

1. To set up an IGP; there is no requirement for the members to have close financial, economic, and organizational links as with the VAT group regime. The IGP could also be used by operators that are independent but want to pursue a common objective and share some services. For example, non-related insurance brokers could set up an independent group of persons to provide them with appraisal services.
2. In terms of permissible activities, the scope of the independent group of persons under current VAT rules is narrower than for VAT groups. Only "directly necessary" services are eligible, while the scope of the VAT group includes any supply (of goods and services) between a group's members.

The IGP and VAT group should thus be considered complementary solutions.

This solution would imply an overrule of CJEU case law. It would also be necessary to introduce flexible rules to be observed by all member states to ensure that the IGP, like VAT groups, could work on a cross-border basis.

Like the VAT group, this solution would have a limited impact, i.e. it would only apply to the insourcing of certain activities, and would need to be combined with other solutions.

h. Fixed VAT deduction rate

The fixed VAT deduction rate is a mechanism that exists in some non-EU jurisdictions, such as Australia, Singapore, and South Africa. This mechanism allows banks and financial and insurance sector operators to deduct VAT on their costs on a lump-sum basis, for example 25%.

Countries that apply this system typically have much lower VAT rates than the EU average of 21% (7% in Singapore, 10% in Australia, 15% in South Africa), which is an important factor to bear in mind.

This solution would simplify the "red tape", because the businesses concerned would no longer calculate their VAT deductions themselves, and the VAT authorities would control such calculations. It might also help mitigate aspects such as hidden VAT, since the cost to be passed on to clients is lower. It may also reduce the cost of outsourcing.

It should also be noted that such a system may imply the concentration outside the EU of activities that give rise to the right to deduct VAT, while ineligible, or partly eligible, activities would remain in the EU.

Moreover, if a single fixed VAT deduction rate was introduced, it could affect the various businesses in a very different way, depending on their activities: some with a very low VAT deduction rate might lose out, while others would gain. Of course, different fixed VAT deduction rates could be introduced to better reflect these realities, but this would make the system more complex and eliminate, at least partly, the advantage of simplification.

[11] Including pragmatic solutions to the difficulties arising from CJEU decisions such as Skandia.

REACTIONS OF THE **PROFESSIONAL ASSOCIATIONS** TO **THE COMMISSION ROADMAP**

4.Reactions of the professional associations to the Commission roadmap

In October 2020, the EU Commission published its roadmap and impact assessment on the FS VAT review. Since then, more than twenty European and national professional associations have published their reactions (https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12671-Review-of-the-VAT-rules-for-financial-and-insurance-services), while others have sent comments directly to the Commission without publication.

The roadmap and impact assessment summarize some of the impacts we have highlighted above.

The main reactions of the associations may be summarized as follow:

1. Generally speaking, all associations support the principle of VAT exemption.
2. The support from investment and pension fund associations for the exemption is particularly strong, because all their clients are individual investors or pension beneficiaries and would impacted if asset management services became subject to VAT, and since the EU has a pension gap estimated at €2 trillion, any measure that would increase the cost of savings might be detrimental in this respect.
3. Other associations, mainly banking associations, may benefit if some services are taxed, because they have more clients that can deduct VAT, and this would solve issues such as hidden VAT. It is also worth noting that French insurers are particularly concerned by the level of insurance premium tax, which can be up to 30% in France (4% or 6% in Luxembourg), and are therefore more open to the imposition of VAT.
4. Although they are generally supportive of the principle of VAT exemption, the associations recognize that the current situation is far from perfect, pointing out the issues we have highlighted above. As such, they strongly support the need to improve the definitions, re-introduce the independent group of persons, and make it possible for VAT groups to work cross-border with clear and favorable rules, etc.
5. The option to tax also attracted some favorable comments.
6. Moreover, the associations emphasize that the international competiveness of the EU's financial and insurance sectors and the risk of delocalization are crucial factors that have been made even more urgent as a result of Brexit.

SUMMARY TABLE OF THE **MAIN SOLUTIONS** AND OF THEIR **POSSIBLE IMPACTS**

5.Summary table of the main solutions and of their possible impacts

The aim of this table is to compare the potential impact of the different potential solutions. It contains some element of judgments. The "score" of the different solutions take does not into account the weight of each of the impact. For example, the risk of delocalization linked to the standard VAT rate is probably more important than the "red tape"saved by the fixed deduction rate. Similarly, we do not envisage the complexity of the implementation of each of these solutions. Each reader could made his own opinion.

		Standard VAT rate	Reduced VAT rate	Zero rate	Option to tax (client-by-client basis)	Revamped definitions	VAT groups	IGP	Fixed deduction rate(s)
1	Impact on VAT receipts	Substantial increase (1)	No or limited impact, depending on the level of the rate (1)	Negative	Limited (1)	Difficult to assess, probably no or limited impact	No or limited impact	No or limited impact	No or limited impact, depending on how the rate(s) is (are) determined
2	Impact on demand	Substantial decrease (1)	No or limited impact, depending on the level of the rate	May be positive	Limited (1)	No or limited impact	No or limited impact	No or limited impact	No or limited impact
3	Does this solve the hidden VAT issue for clients that can deduct VAT?	Yes (2)	Yes (2)	Yes (2)	Yes (2)	No	Nor or limited positive impact because the decrease in total hidden VAT may be small	Nor or limited positive impact because the decrease in total hidden VAT may be small	No or limited impact, depending on how the rate(s) is (are) determined

4	**Impact for clients that cannot deduct VAT (individuals, NGOs, public bodies)**	Negative (1)	No or limited, depending on the level of the rate (1)	Positive (2)	No impact	No or limited impact	Limited positive impact because there may only be a small decrease in the non-deductible VAT of service providers if they pass on all or part of the savings to their clients	Limited positive impact because there may only be a small decrease in the non-deductible VAT of service providers if they pass on all or part of the savings to their clients	No or limited impact, depending on how the rate(s) is (are) determined
5	**Does this help level playing field?**	To some extent, but the difference in VAT rates may also have a negative impact	To some extent, but the difference in VAT rates may also have a negative impact	Yes	Yes (assuming the regime is harmonized in all member states)	Yes	Yes (assuming the regime is harmonized in all member states)	Yes (assuming the regime is harmonized in all member states)	No or limited impact, depending on how the rate(s) is (are) determined
6	**Competiveness with non- EU operators/risk of delocalization**	High threat	Limited threat if the rate is in the lower range (e.g. around or less than 5%)	Positive (cf. UK)	Positive	No or limited impact	Positive	Positive	No or limited impact, depending on how the rate(s) is (are) determined
7	**Does this solve the in/outsourcing issue?**	Yes	Yes	Yes	Partly	No	Only for insourcing	Only for insourcing	No or limited impact, depending on how the rate(s) is determined
8	**Does this solve the definitions issue?**	Yes	No	No	No	Yes	No	No	No
9	**Does this solve the taxable basis issue for margin-based products?**	No	No	Yes	No	No	No	No	No
10	**Does this solve the practical**	No	No	Yes	No	No	No	No	No

	difficulties for high frequency trading?								
11	Does this solve the practical issues involved in determining VAT deduction entitlement?	Yes (if all exemptions are removed)	Yes (if all exemption are removed)	Yes (if all exemptions are removed)	No	No or limited impact	No	No	Yes
	Total number of issues solved and positive impacts (out of 11) (3)	6	5	9	6	2	4	4	1
	Comment	Taxation at the standard VAT rate is a major threat to competiveness with non-EU countries and EU demand.	Taxation at a reduced rate should have the advantage of solving issues such as hidden VAT, outsourcing and exemption, with limited impacts on tax receipts and on demand, and without major delocalization risks	The sole negative impact is on VAT receipts. Recent changes in the UK could help in estimating this impact.	The main effect of the option to tax is to help solve the issue of hidden VAT for businesses, and should have other positive impacts. It might involve some practical difficulties that should not, however, be seen as insurmountable based on the German experience.	Revamped definitions would be ineffective if all services that are currently exempt became taxable or zero rated. Otherwise, revamped definitions are necessary and should be combined with other solutions.	The VAT group regime may be part of the solution to the issue of VAT on out sourcing, and may help decrease the total VAT costs incurred by service providers and possibly their clients. It should, however, be combined with other solutions.	For the IGP regime, see the comment on the VAT group regime.	The fixed VAT deduction rate(s) is (are) only a partial solution and should be combined with others. Could imply a risk of delocalization.

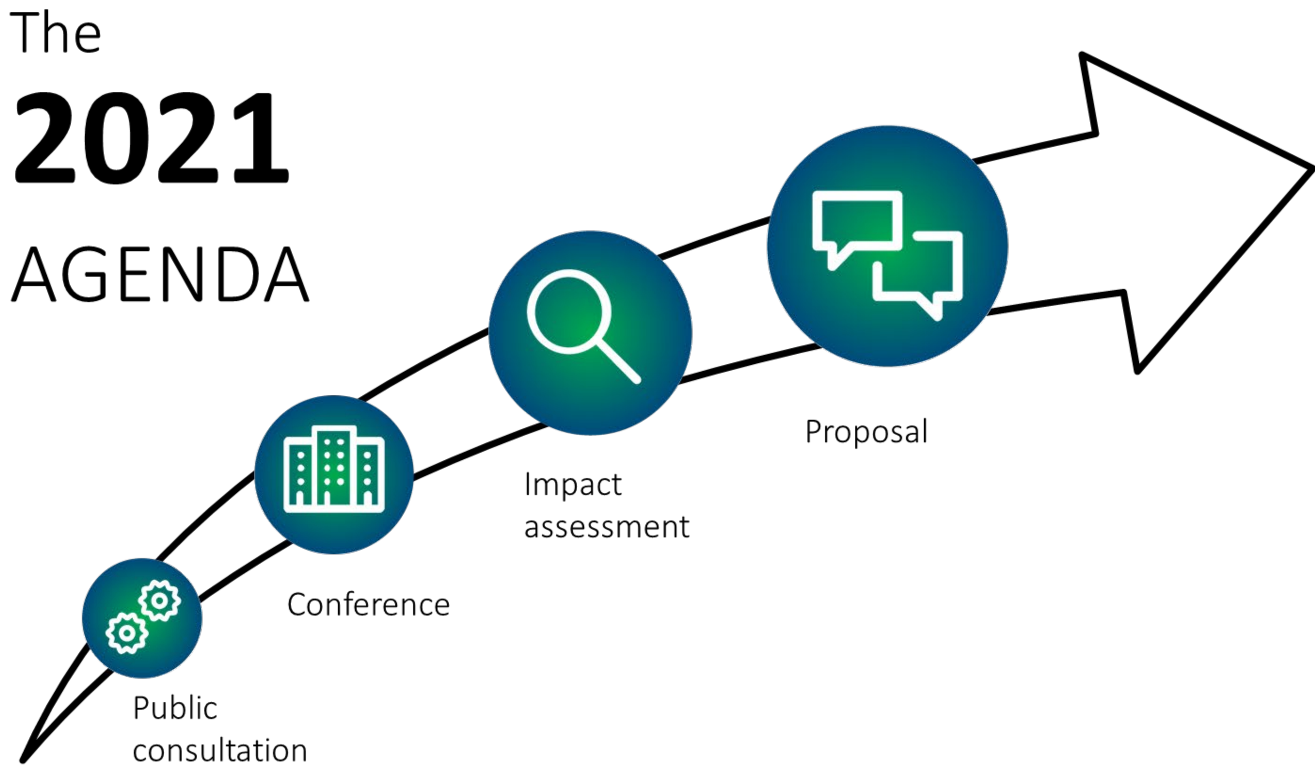
(1) Based on the Report conducted by a consortium of researchers for the EU Commission
(2) Assuming service providers pass on, at least partly, to their clients the VAT they would be entitled to deduct VAT
(3) “No impact” or “limited impact” or “no or limited impact”answers do not equate to a positive impact

THE **2021**

AGENDA

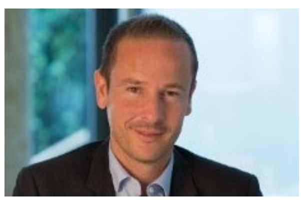
6. The 2021 agenda

As mentioned above, the next steps based on the timetable announced by the EU Commission should be:



CONTACTS

7. Contacts



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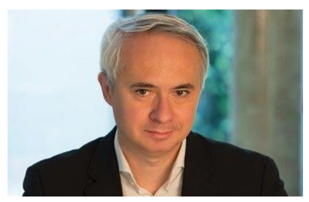

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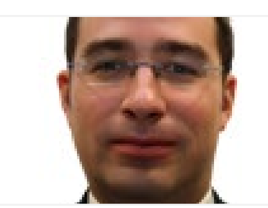

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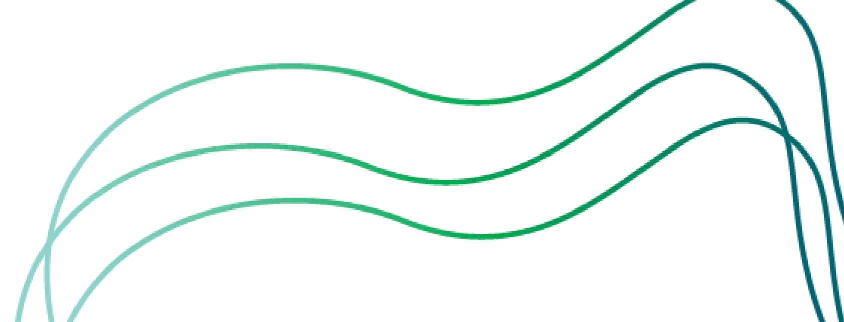

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