

## Insurance Europe comments on the need to modernise VAT rules for financial services

Our reference:	ECO-TAX-18-012	Date:	March 2018
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Pages:	4	Transparency Register ID no.:	33213703459-54

### Introductory comments

Insurance Europe believes that more efforts to harmonise Value Added Tax (VAT) in the EU are needed, particularly in the field of financial services. Insurance Europe calls on the European Commission to launch an initiative addressing the lack of neutrality between Member States in respect to the application of EU VAT law and the associated risk of double taxation. This initiative should have the following objectives:

- Establishing a level playing field on VAT for all financial services providers.
- Creating legal certainty by implementing the jurisprudence of the European Court of Justice (ECJ), while overcoming ECJ rulings that may be too restrictive.
- Ensuring that European VAT law is fit and proper for the modern business environment and can respond to current challenges.

The motivation for the 2006 Commission proposal (which was ultimately abandoned) still holds true and has become more urgent. The VAT liability of financial services transactions continues to be governed by the VAT Directive that was implemented in 1977 and written even earlier. Insurance Europe believes that this Directive is in many respects outdated and not correctly applicable to modern financial services. In particular, recent rulings of the ECJ have shown that there is a need to adapt the VAT Directive to current market realities. It must also be accepted that ECJ rulings are an inefficient means of providing certainty to the European VAT system.

Due to this lack of adaptation to modern financial services and current market realities, Member States endeavour to find a balance for their national market and may implement their own interpretation of the law. This results in an uneven playing field within the EU, causing VAT to become a key factor affecting the competitiveness of the EU and a driver in business decisions for financial services companies. It also leads to inappropriate taxation of financial services providers and lost VAT income for Member States. Insurance Europe is of the view that the lack of harmonisation of VAT law across the EU is a significant barrier to a Capital Markets Union (CMU).

For these reasons, Insurance Europe is calling for the modernisation of VAT rules for financial services to be put back on the agenda of the Commission. In what follows, Insurance Europe highlights some of the areas in that the insurance industry lacks the needed clarity with respect to its VAT liability and that should be addressed in the context of a potential update of the VAT Directive.

Main areas in need of modernisation

### **Cost-sharing groups**

The European Commission has already recognised the importance of cost-sharing groups (CSGs) in Article 132(1)(f) of the VAT Directive. But on 21 September 2017, the European Court of Justice (ECJ) issued two rulings related to the application of Article 132(1)(f): [Case C-605/15 Minister Finansów v Aviva](#) and [Case C-326/15 DNB Banka v Valsts ienemumu dienests](#) explicitly state that CSGs in the financial sector cannot benefit from a VAT exemption. According to the ECJ, the exemption from VAT is limited to CSGs whose members conduct activities in the public interest (eg, education, healthcare).

Previously, it had been understood that CSG schemes can cover services provided by CSGs to their members that are directly necessary for the VAT exempt activities of these members, regardless of the type of VAT exempt or out of scope activities conducted by the members. These rulings will result in an additional VAT burden for insurers who rely on CSG schemes to mitigate VAT leakage.

Insurance Europe believes that it is necessary to review the VAT Directive to explicitly allow CSGs independent of the type of activities conducted by members of the group.

### **Scope and application of the exemption for financial services & option to tax**

Financial services, including the provision of insurance, have generally been exempt from VAT since 1977, when the VAT Directive was implemented. Article 135(1)(a) of the Directive provides an exemption from VAT for insurance and reinsurance transactions and related services performed by insurance brokers and insurance agents. However, as a result of this exemption, insurance firms cannot recover VAT on their purchases of services or goods. This results in "hidden" VAT charges for supplies, such as office equipment or services that have been outsourced, which financial services or insurance companies need to run their businesses. Moreover, the existing rules have not been uniformly applied across EU Member States.

Insurance Europe believes that more clarity and legal certainty is needed for financial and insurance services operators regarding the scope of the VAT exemptions that applies to the industry. In addition, the implementation of an option to tax for property & casualty insurance should be reconsidered. It should also be investigated how the impact of non-deductible VAT on the cost of doing business of insurers can be limited. Besides the non-deductible VAT, Insurance Premium Tax (IPT) is charged on several insurance services in all EU Member States and IPT rates have tended to increase over the past few years.

### **VAT grouping**

Article 11 of the VAT Directive provides EU Member States with an option to introduce VAT grouping schemes into their national legislation. This allows tax authorities to consider all members of a group - under certain conditions - as a single taxable person for VAT purposes. Consequently, intra-group transactions are "neutralised" as the rights of deduction are determined at group level. However, only a few Member States are currently making use of this option and they do so in different ways (eg, whereas Article 11 of the VAT Directive only asks for financial, economic and organisational links, VAT law in Germany requires an incorporation on a financial, economic and organisational level). Some Member States treat this as an administrative simplification (ie, allowing the filing of a single return) without neutralisation of intra-group supplies.

The option to treat linked persons as a single taxable person and the cost sharing mechanism are useful in sectors exempted from VAT where group members consequently do not fully recover VAT. Hence, these options are important for the financial sector that is largely exempt from VAT on financial activities.

In order to avoid any distortion between financial operators located in different member states, Insurance Europe recommends that the VAT Directive be amended in order to make the option for VAT group treatment mandatory in every Member State's legislation.

Furthermore, the possibility of cross-border VAT groups should be introduced. Since the Common Consolidated Corporate Tax Base (CCCTB) is currently being discussed at EU level and is intended to be implemented sometime in the next few years, this new framework should be accompanied by the possibility to form cross-border VAT groups. This would facilitate cross-border trade in services in the single market and ensure a level playing field. As addressed by the European Court of Justice (ECJ) in Case [C-386/14 Groupe Steria SCA v Ministère des Finances et des Comptes publics](#), Article 49 TFEU requires the abolition of restrictions on the freedom of establishment. It is apparent from the Court's case-law that freedom of establishment is hindered if, under a Member State's legislation, a resident company having a subsidiary or a permanent establishment in another Member State suffers a disadvantageous difference in treatment for tax purposes compared with a resident company having a permanent establishment or a subsidiary in the first Member State. Following this ruling, the general territorial approach for grouping regimes for Corporate Income Tax (CIT) purposes are expected to be in breach of article 49 TFEU.

In order to avoid any distortion between financial operators located in different Member States and in line with the ECJ ruling in Case C-386/14, Insurance Europe recommends that the VAT Directive be amended in order to include the cross-border effect for VAT groups.

### **Outsourcing and third-party delegation**

The extraordinary globalisation of industries, including insurance, has led to the need to reorganise the corporate structures and means of supply traditionally employed in the sector. To increase its competitiveness and to keep track with the efficiency standards of the modern economy, an insurance company often obtains from different entities supplies that are necessary to deliver the final insurance service to the consumer.

The European insurance industry recognised the necessity of operating with further efficiency and economies of scale to remain competitive. Insurance companies have turned to outsourcing as an effective way to obtain a wide range of services that are necessary to the execution of the insurance activity. In fact, outsourcing appropriate activities can lead to more efficiency, as well as reduced costs, especially for small and medium-sized insurance companies.

However, outsourcing is currently constrained by VAT obstacles, which the VAT Directive review had originally planned to overcome. In fact, major VAT obstacles to the good functioning of the single market would remain unsolved if no measure is taken towards the amendment of the current VAT treatment regarding outsourcing activities.

It is Insurance Europe's view that the elimination of VAT obstacles should apply to the arrangements that are needed to carry out insurance business, such as legally foreseen in European Directives. These features should be determined by the nature of the service provided itself, rather than by the person providing it. Outsourced services that are necessary to the insurance business must benefit from a VAT exemption; otherwise a true level playing field would not be achieved

On this basis, outsourced activities such as underwriting of risk, risk management, insurance company administration, policy administration, product development, marketing, identification of new products and opportunities, investment management and claims handling, which are specific and essential to carrying out insurance business, should benefit from a VAT exemption in all Member States.



A revised VAT Directive should clarify under which conditions a “financial service delegated to a third party” will qualify for an exemption given that: (a) the wording is currently subject to a number of different interpretations among Member States; (b) the aim of modernizing the VAT rules is to improve legal certainty and avoid additional costs caused by “hidden VAT” to ensure neutrality for financial institutions.

Revising the VAT Directive in this respect would also mean harmonising VAT rules according to the significant number of ECJ rulings on this topic. Of particular relevance to the insurance industry is the ECJ ruling in the case [C-40/15 \*Minister Finansow v Aspiro\*](#), which gave a strict interpretation of the VAT Directive by judging that outsourced claims handling services cannot benefit from the exemption, unless they are performed by an insurance broker or agent. Insurance Europe disagrees with this ruling on the basis that the outsourcing exemption should follow the nature of the service and not the status of the person carrying it out or their role in the insurance operation. However, Insurance Europe also sees a need to change existing VAT rules to adjust to ECJ rulings, thereby ensuring the needed harmonisation of VAT rules at EU level.

### **Transfer of insurance and reinsurance contracts**

There is a strong need for an explicit VAT exemption for the transfer of (re)insurance contracts and contract portfolios. There is currently no consistency within the single market on this topic. Some Member States apply this exemption and some generally treat the transfer of portfolios as the transfer of a business going concern, which is not taxable. A clear exemption would guarantee the respect of the VAT neutrality principle and would not hinder necessary business restructuring. A level playing field both within the EU and with respect to non-EU insurers would also be established.

Insurance Europe is the European insurance and reinsurance federation. Through its 35 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers generate premium income of €1 200bn, directly employ over 940 000 people and invest over €10 100bn in the economy.