



FS/MT  
EBF Ref. N° 0120

Brussels, 3 May 2012

**Ms Margrethe VESTAGER**  
Minister for Economic Affairs and the Interior  
Denmark

**Mr Thor Möger PEDERSEN**  
Minister for Taxation  
Denmark

**Subject:**        *Comments on the European Commission's proposal to reform the VAT rules applied to financial and insurance services*

Dear Minister Vestager and Minister Pedersen,

The European Association of Co-operative Banks (EACB), the European Association of Public Banks (EAPB), the European Banking Federation (EBF), the European Fund and Asset Management Association (EFAMA), Insurance Europe (formerly the CEA) and the European Federation of Insurance Intermediaries (BIPAR) would like to share with you our common position to the work concerning the European Commission's proposals to reform the application of the VAT rules on insurance and financial services. We kindly note this letter should be read in conjunction with a previous letter (annex) prepared by the EBF, EFAMA and CEA (now Insurance Europe), concerning the VAT treatment of financial and insurance services and sent to the Polish Presidency on 24 October 2011, which all above mentioned organizations agree with.

The VAT Directive is vitally important to our organizations not only to ensure that EU businesses are not put at a disadvantage to their non-EU competitors, but also to support a single and effective European market for insurance and financial services.

We appreciate the cooperative dialogue with previous Presidencies on this very important issue. We would however like to emphasize our profound concern that discussions on the VAT Directive have stalled and that, in consequence, the key VAT issues for the insurance and financial industry remain unresolved. Moreover, we are concerned that holding up discussions on the VAT Directive could possibly mean that the entire work could be dropped and no further work will be done to implement it.

The motive for our concern is that the Danish Presidency has taken the decision not to continue any further work on the Directive. It is our concern that after so many years of work by the European Commission, different Presidencies, Member States' negotiation teams and various stakeholders there is still no legislation that clearly defines which insurance and financial services should be exempt from VAT and that this Directive will not be implemented due to these unresolved items.

The purpose of the proposals to reform the application of the VAT system to insurance and financial services as adopted by the European Commission on November 2007 was to modernize and simplify the legislation on financial and insurance services, to add clarity to the rules to provide greater surety of treatment and to provide greater harmonisation among Member States.

Due to the unresolved differences over the Directive the current situation has left Member States uncertain as to whether to implement changes based on case law and the draft Directive or remain with the dated current law. If this position remains the EU is in danger of having the law making process and regulations undertaken by the Court of Justice of the European Union through litigation initiated by taxpayers, the European Commission and tax authorities. In addition, the failure of the project would continue condemning economic operators acting on the EU single market to competitive distortion and inefficiencies as well as disadvantages in competition with non-EU economic operators.

Given the importance of the issues at stake and the considerable effort expended to date on the review, we ask the Council and the Presidency to continue the work towards reaching resolution in this area as industry needs the new Directive to enable greater harmonisation of the tax as well as greater surety of treatment within the insurance and financial services industry. We urge also the upcoming Cypriot Presidency to continue the work on the VAT Directive as a priority in a bid to resolve the current points of contention.

We thank you for your attention and hope you will find our letter constructive. If you require any further information or a more detailed explanation of our comments, concerns and suggestions on the matters raised in this letter, then we would be glad to provide this as well as to meet with the Presidency and the European Commission.

Yours sincerely,



**Michaela Koller**  
Director General  
Insurance Europe



**Guido Ravoet**  
Chief Executive  
EBF



**Peter De Proft**  
Director General  
EFAMA



**Nic De Maesschalck**  
Director General  
BIPAR



**Hervé Guider**  
General Manager  
EACB



**Henning Schoppmann**  
Secretary General  
EAPB

Copy to: Mr Søren Olsen, Fiscal Attaché to the Permanent Representation of Denmark to the European Union  
Ms Elpida Georgiadou, Mr Nicolas Pavlou, Ms Nadia Flouri - Permanent Representation of the Republic of Cyprus to the European Union (Indirect Taxation-VAT)



## ANNEX

Brussels, 24 October 2011

**Mr Maciej GRABOWSKI**

Undersecretary of State

Ministry of Finance of the Republic of Poland

**Subject:        *Comments of the European financial and insurance sector as regards the VAT treatment of financial and insurance services***

Dear Minister Grabowski,

The European Insurance and Reinsurance Federation (CEA), the European Banking Federation (EBF), and the European Fund and Asset Management Association (EFAMA) welcome the opportunity to share with you the position of the European financial and insurance sector on the current discussions about the VAT treatment of insurance and financial services. We appreciate the cooperative dialogue with your Presidency colleagues on this important issue; we would, however, like to emphasize that the Directive and the Regulation should be finalized as soon as possible in order to provide businesses with the required legal certainty.

The three mentioned organizations represent respectively the European banking sector and the interests of some 5000 European banks accounting for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only (EBF), all types of European insurance and reinsurance undertakings, accounting for around 95% of total European premium income (CEA), and the European investment management industry, representing approximately EUR13.8 trillion in assets under management (of which EUR 8.1 trillion was managed by approximately 54,000 funds at end July 2011) (EFAMA).

The VAT amendment Directive on insurance and financial services is vitally important not only for the creation of a single and effective European market for insurance and financial services, but also to ensure that EU businesses are not put at a disadvantage to their non-EU competitors.

Over the last five years, considerable effort has been expended by the European Commission, different Presidencies and Member States' negotiation teams in an attempt to arrive at legislation that clearly defines which insurance and financial services should be exempt from VAT. The latest definition of exempt services is not, however, sufficiently robust. It will not keep pace with new developments within the insurance and financial services sector or create legal certainty for Member States and businesses, nor will it remove actual, or potential, competitive distortions between insurance and financial services supplied across different Member States, and between EU and non-EU businesses. Given the importance of the issues at stake and the considerable effort expended on the review, it would be unfortunate if any new Directive were found to be inadequate on or within a few years of adoption by the Member States.

The outstanding issues which we consider to be of paramount significance and, thus, requiring further analysis and discussion are:

- **Outsourcing** – The introduction of a new specific VAT outsourcing exemption should not entail either an extension or a narrowing of the existing VAT exemption for supplies of outsourced services to insurers and other financial service providers. We would, however, emphasize the importance of the new exemption clarifying the qualifying conditions for an outsourced service to be exempt, given that the exemption is currently subject to a number of different interpretations among Member States.
- **Derivatives** – Member States treat derivatives differently for VAT purposes and the currently proposed wording does not resolve these areas of confusion or disagreement. Moreover, the proposed implementing regulations are limited to options and do not deal the wider scope of derivatives.
- **Transfer of insurance and reinsurance contracts, credit contracts and contract portfolios** – There is a need for an explicit exemption for these items in order to spread risk and guarantee the VAT neutrality principle when a business restructures.
- **Management of investment funds and pension funds** – An appropriate exemption is required for the management of retail and institutional investment funds and pension funds to ensure that (smaller) investors investing their money directly or indirectly through such funds do not bear a greater tax burden than those (often larger) investors able to create a diversified portfolio through direct investments in securities, and also to ensure that EU funds are not less attractive than comparable non-EU funds.
- **Specific exclusions from exemptions** – Clarification is required to ensure that the supply of certain services, whilst specifically excluded from exemption under a particular heading, may still be VAT exempt under general VAT principles when their supply forms part of a composite supply, such as *global custody* and *fund distribution services*, of which the principal elements are exempt.
- **Financial transfer & financial deposit taking** – greater clarity over what work in preparing a transfer or running and administering an account is required to ensure that the financial sector can understand what qualifies for exemption especially as much of these processes are outsourced.

For further information and a more detailed explanation of our comments, concerns and suggestions, please refer to the attached annex to this letter.

We thank you for your attention and hope you will find our comments constructive. If you require any further information on the matters raised in this letter, or its annex, then we would be glad to provide this.

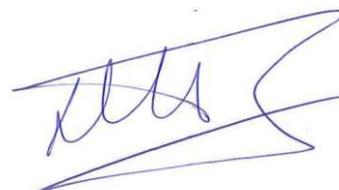
Yours sincerely,



**Michaela Koller**  
Director General  
CEA



**Guido Ravoet**  
Chief Executive  
EBF



**Peter De Proft**  
Director General  
EFAMA



## **1. Outsourcing**

As a general remark, the European financial and insurance sector faces - as does every other industry - a considerable need for a consequential growth of outsourcing due to an evolving business environment and its related requirements. This new business environment is characterised by increased prospects for externalisation due to the evolution in IT and communication technology, changes in market and corporate structure, and amplified competitive pressure, especially due to globalisation.

In this context, the European financial and insurance sector is obliged to externalise their services in a cost efficient manner as they do not have a right to deduct VAT. This may to some extent be achieved, through VAT grouping (where national law has implemented VAT groups) or cost sharing arrangements (where national law has implemented cost sharing arrangements). However, VAT grouping and cost sharing arrangements can only partially meet the European financial and insurance sector's need to outsource essential and specific services in a cost effective manner and they do not as a rule allow cross-border cooperation. Moreover, the legal requirements of these tools may differ from Member State to Member State and not all European financial and insurance companies can benefit from them. As a result, in the current situation VAT neutrality can best be assured via the VAT outsourcing exemption.

The introduction of a specific VAT outsourcing exemption does not entail an extension of existing provisions on VAT exemption of financial and insurance services, but rather implies an adjustment of the scope of exempt services in order to ensure that the exemption better reflects the complexity and diversity of the modern European financial sector whilst staying broadly within the limits of the existing provisions.

Furthermore, as shown by both case law and the present discussions between Member States, the wording is subject to a number of different interpretations. Given that the aim of modernising the VAT rules for financial services is to improve legal certainty and avoid additional costs caused by "hidden VAT" to ensure neutrality for financial institutions, we believe that it is critical that the new Directive and Regulation clarify under which conditions an outsourced financial service qualifies for exemption. We would welcome greater clarity over some of the terms contained in ECJ rulings, such as "specific and essential". In addition, we would welcome clarity on whether, and under which conditions, a service is deemed to constitute a distinct whole. These definitions are key and should not be left to national legislation and national courts to determine. Finally, we consider that the revised text should acknowledge the fact that the way in which a service is rendered, i.e. whether undertaken manually or automatically via electronic processing, is not decisive in determining the VAT treatment.

### *1.1 Competitiveness of the European financial and insurance sector.*

Should an appropriate VAT outsourcing exemption be adopted, the following positive effects would arise with respect to the competitiveness of the European financial and insurance sector:

– *Deepening Internal Market*

The current restrictions on the VAT outsourcing exemption render it difficult for European financial and insurance companies to expand from their home market into other EU markets, since they cannot utilise third party service providers without incurring non-recoverable VAT.

For instance, a French company expanding into the German market cannot outsource specific and essential insurance activities such as claims handling to a German company specialized in this field without being subject to German VAT. Instead, in order to benefit from a VAT reduction, the French company would need to set up its own corporate structure in Germany. These costs often represent a prohibitive initial investment and hence are a barrier to market entry.

The VAT outsourcing exemption would remove these market distortions and related entry barriers. It would therefore have a positive impact on the functioning of the internal market.

– *Cost Savings*

VAT exemption for specific and essential outsourced services would enable European financial and insurance companies to realise cost savings by minimising the impact of irrecoverable VAT and putting in place an optimal corporate structure. Furthermore, a redefined outsourcing exemption would help small and medium sized European financial companies to generate savings as it would enable them to access similar economies of scale as larger companies through shared service agreements.

Finally, lower costs reduce the burden on capital requirements in the context of the new, comprehensive EU legislations on capital and risk management (Solvency II and Basel III, implementation date 1 January 2013).

– *Optimal corporate structure*

The inability to recover VAT on third party services creates an incentive for vertical integration of the European financial and insurance sector. European financial and insurance companies are more inclined to retain potentially taxable services in-house than buy them from a specialist supplier where non-recoverable VAT would be generated. This runs counter to current competitive pressures which encourage the pursuit of cost reduction strategies and a trend away from vertical integration towards greater dependence on outsourcing. As a result of non-recoverable VAT, corporate structures have been put in place, which are considered less than optimal from a regulatory or corporate tax perspective, in order to decrease VAT costs.

Therefore, the VAT exemption on outsourcing would enable European financial and insurance companies to freely organize their corporate structures and choose the most effective and efficient business model regardless of VAT (which should always be a business neutral tax).

## *1.2 Level playing field*

With respect to the issue of achieving a level playing field, the VAT outsourcing exemption on financial and insurance services is important for the following reasons:

– *Equal treatment of financial and insurance services*

It is of utmost importance that the VAT outsourcing exemption is applied consistently for all the participants of the EU financial and insurance market. In this respect, the current proposals on the VAT exemption have removed the clause concerning the management of insurance contracts while including exemption for the management of credit by the person granting it. In this respect, it is necessary to treat the management of insurance contracts in the same way as exemption for the

management of credit in order to avoid competitive distortions between the banking and the insurance sectors.

– *Level playing field with non-EU financial and insurance companies*

Because of the impact of non recoverable VAT, European financial and insurance companies are disadvantaged in comparison to their equivalents in other developed economic regions, in particular the U.S, as they cannot use the services of third party providers. In the U.S. there is no VAT system and although individual states impose single-stage retail sales taxes, such taxes do not apply to financial and insurance services. As a consequence, the non-recoverable VAT on third party administration decreases the attractiveness of financial and insurance products of EU companies in comparison to U.S. companies within the EU.

### *1.3 Budgetary implications*

Having regard to the importance of budget security, the European Commission stated in its Memo 07/519 on the modernisation of VAT rules applied in financial and insurance services:

*“Because the Commission is prioritising a more consistent application of the exemption, it cannot be excluded that for some Member States certain services which they now consider as taxable will be exempt and vice versa. This has revenue implications of course but the Commission’s view is that the overall effect will be small or even neutral. Much of the VAT theoretically lost is not actually levied today as operators may minimise this by appropriate (costly) organisational measures. Also, overall efficiency gains leading to higher direct taxes etc. will compensate for limited revenue losses.”*

Furthermore, with respect to fiscal concerns expressed in particular by Member States that interpret the VAT outsourcing exemption in a restrictive way, it is worth mentioning that in these countries European financial and insurance companies prefer to perform activities internally rather than outsource them. Therefore, if the VAT exemption for outsourcing in these countries is adjusted as set out above there will be no significant budgetary implications regarding VAT revenue.

Finally, other services supplied in support of outsourced financial and insurance services which are not an essential and specific part of the insurance policy (e.g. car rental or hire, provision of replacement goods, etc.) would continue, as now, to attract VAT. The proportion of these services is likely to remain at current levels.

## **2. Derivatives**

The current VAT treatment for derivatives differs between the various Member States. We consider it vital that the new directive removes these differences to provide consistency of treatment across the EU. This is important to promote operational efficiencies, whereby a business can be certain of the VAT treatment applicable irrespective of the Member State in which the transaction occurs, and to promote neutrality across the EU in respect of comparable transactions notwithstanding the fact that there are variations in the legal nature of derivatives across the different jurisdictions.

The proposed wording does not resolve these areas of confusion or disagreement as to the VAT treatment. By way of example, some Member States consider the wording in article 135(1)(gb) of the proposed directive to be incompatible with the implementing regulations (No 282/2011 of 15 March 2011) on the basis that whilst the proposed directive states that derivatives shall only be exempt if profits and losses are derived without any possibility of delivery, the implementing regulations state that derivatives must represent a “supply of services... distinct from the underlying transactions to which the services relate”, i.e. such Member States take the view that, under the implementing regulations any possibility of delivery of an underlying asset should not be the determining factor for exemption and only the actual delivery of the goods will be subject to VAT (subject to fiscal warehousing).

Other Member States do not view the proposed directive and the implementing regulations as incompatible. This is on the basis that, whilst a derivative must be viewed as a distinct service in its own right, it does not necessarily follow that it is impossible for the VAT liability of that derivative to be driven by the nature of the underlying transaction. This would not be a unique situation, as similar principles already exist in relation to financial intermediation. Clarification on this point and these differing interpretations is key to ensuring consistency of treatment across the Member States. It is noted however that the implementing regulations only address options and not the wider scope of derivatives.

In addition, in some jurisdictions, e.g. Germany, financial futures and forwards are out of the scope of VAT independent of the underlying transaction. They are treated as a bet on differences and therefore there is no supply of services for consideration. If those contracts are treated as VAT exempt under the proposed directive, this might have considerable consequences on the input VAT deduction and thus a distortive impact especially for business operators who use those instruments to hedge risk for their business.

Additional clarification is also required in light of the confusion which can arise between exchange traded commodities and exchange traded funds, which are sometimes presented as similar vehicles. For instance, clarification is required in relation to application of the VAT exemption within the framework of the swap-based replication method used by certain categories of exchange traded funds.

We welcome the suggestion of a special scheme being introduced for exchange traded commodities. We would expect this special scheme which will be restricted to market participants (non-members and members) of recognized specified exchanges, within which transactions are considered to be within the scope of VAT but no VAT is levied on the transactions (suspension of tax). However market participants whose transactions are cleared and executed on the specified exchanges are entitled to an input tax credit. The rationale for no VAT being levied on any sale executed and cleared on the recognized exchange is that the underlying physical deliverable commodity to which the transaction is concerned will be located in a fiscal warehouse and/or in a tax free zone and therefore will involve the delivery of goods which are technically outside of the EU. In summary, the key recommendation that we have with regard to this provision, is to extend the suspension regime to (taxable) transactions between “non-member and member”.

A suspension scheme across all participants would increase the competitiveness of the EU by reducing the administrative burden of accounting for VAT on such transactions, without leading to a loss of revenue as VAT would still be charged on supplies to the final consumer where actual delivery takes place. Furthermore, given that similar schemes already exist, notably in the UK, the introduction of an EU-wide scheme would ensure consistency of treatment across the EU.

### ***3. Transfer of insurance and reinsurance contracts, credit contracts and contract portfolios***

We support the fact that, under the current proposals, the transfer of a credit position and assumption of a debt position, and the transfer of credit contracts are explicitly exempted pursuant to Article 135(1)(d) of the Directive and Article 5(1) of the Regulations. We would, however, also support:

- a. the explicit exemption of the transfer of insurance and reinsurance contracts in the Directive; and
- b. clarification that the exemption will cover the transfer of existing insurance and reinsurance contracts and credit contracts, where supplies made under such contracts would themselves fall to be exempt.

In our opinion, the transfer of insurance and reinsurance contracts should be exempt from VAT in the same way as the transfer of credit contracts, as charging VAT on any such transfers would be in opposition to the VAT neutrality principle. Indeed, the imposition of VAT on any such transfers would entail an additional cost, on the basis that the buyers would, as exempt insurers or financial

institutions, be unable to recover the VAT cost. The above approach would not be reasonable as the buyers would continue to carry out the insurance or financial transactions which are exempt from VAT. Moreover, this would work against the European Commission's stated objective to reduce the impact of non-deductible VAT in the financial and insurance sectors.

Furthermore, VAT on the transfer of insurance and reinsurance contracts or credit contracts would seriously hamper the business activity needs of insurers and financial institutions. It is common practice that insurers, reinsurers or financial institutions transfer part of their businesses in the form of contracts to other insurers, reinsurers or financial institutions in order to spread risk and carry out their business activities. It should also be noted that the Solvency II Directive (Directive 2009/138/EC) is expected, on implementation in 2013, to lead to a need for corporate reorganisation within the insurance industry. It is, therefore, important that the new Directive caters for these forthcoming regulatory changes.

We believe that an explicit and clear exemption would guarantee a level playing field within the EU for the transfer of contracts and prevent a business advantage to non-EU insurers and financial institutions, especially bearing in mind that:

- a. the exemption for a transfer of a business as a going concern ("TOGC") has not been applied in all Member States and, moreover, has not been implemented uniformly across the Member States who have adopted it; and
- b. non-EU insurers and financial institutions would be able to acquire portfolios of contracts without VAT due to the effect of the place of supply rules (which, in the absence of an exemption for the transfer of contracts, would be detrimental for such EU insurers and financial institutions as are unable to benefit from the TOGC exemption).

Finally, in our opinion, the explicit exemption of the transfer of insurance and reinsurance contracts is necessary to avoid distortion of competition resulting from the fact that the transfer of portfolios of credit contracts is currently treated in most Member States as being exempt from VAT.

#### ***4. Management of investment funds and pension funds***

The main motive behind the exemption for management of investment funds and pension funds is to ensure that investors investing their money through funds do not bear a greater tax burden than those investors investing their money directly in securities, as this would contradict the principle of neutrality. In this respect, there are two key issues which must be borne in mind, namely that:

- a. it is the smaller investors who would be most impacted by a narrow interpretation of the exemption, as they would be less likely to be able to create a diversified portfolio in their own right (in this respect, there is no reason to distinguish between retail and institutional funds, as investors in institutional funds are often themselves raising capital from such smaller investors); and
- b. a narrow exemption would make EU funds less attractive vis-à-vis non-EU funds, which would damage the competitiveness of the EU funds industry.

Another key issue which must be taken into account when agreeing the provisions of the draft Directive and Regulation is the need for legal certainty.

In addition to the above overarching comments, we have also set out below a few of our main concerns:

**a. Definition of “investment funds”**

We believe that the definition of “*investment funds*” should include all undertakings for collective investment raising capital from investors with the main object of investing in securities, cash, financial assets or real estate. As stated above, we do not consider that there is any reason to distinguish between retail and institutional funds. Furthermore, we believe that it is important that the definition should apply to funds with the “*main*” rather than the “*sole*” object of investing in the stated asset classes, as otherwise the definition could exclude funds investing a *de minimis* percentage of their overall capital in other asset classes. It is also considered that the definition should be amended to refer to funds which “*are subject to rules designed to protect investors or operate on the principle of risk spreading*”, as otherwise the exemption may be interpreted as only covering regulated UCITS funds and not certain alternative investment funds governed by the AIFMD, such as open-ended real estate funds, for which the other requirements of the definition of “investment funds” are fulfilled but only the manager is regulated.

**b. Definition of “pension funds”**

The clear policy objective of the definition of “*pension funds*” is to ensure that the scope of the fund management exemption includes supplies of management services provided to defined benefit occupational pension funds. There is, however, a concern that the current definition of “*pension funds*” may not achieve this objective if the ECJ decides in favour of the UK tax authority (“**HMRC**”) in the case of *Wheels Common Investment Fund Trustees Limited*, as the thrust of HMRC’s argument is that such pension funds are not “*operating similarly to investment funds*”. Whilst an amendment to the compromise texts may be feasible in the event that the *Wheels* case is decided in HMRC’s favour, it would seem appropriate to “future proof” the definition to ensure that the policy objective is met (for example, by replacing the words “*undertaking for collective investments operating similarly to investment funds*” with “*common asset pools established to facilitate the investment of funds*”).

Given that the compromise texts are providing clarity on the VAT treatment of supplies management services to defined benefit occupational pension funds, it would also be helpful to receive confirmation that management of insurance-backed pension funds will continue to be exempt under the insurance intermediary exemption.

**c. Exclusion of investment advice from the scope of the exemption**

The fund management exemption in the current draft of the Regulation would exclude supplies of “*investment advice*”, but would cover outsourced “*investment management*”. There is, however, very little difference in practice between trade-specific “*investment advice*” (i.e. advice which can be linked to actual or prospective trades by the fund) and outsourced “*investment management*”.

The term outsourced “*investment management*” is usually used to refer to circumstances where a third party service provider actually makes the final investment decision on a discretionary basis. By contrast, the term “*investment advice*” is usually used to refer to arrangements under which the third party service provider gives recommendations as to which assets to purchase, sell or hold, but the fund’s board of directors (or management company) retains the authority to accept or decline such recommendations. In some jurisdictions, the decision of the fund’s board of directors (or management company) will, in practice, only be a formal ratification of concrete (i.e. trade-specific) advice, which may even be given within minutes of submission of the recommendations. We are of the view that such trade-specific “*investment advice*” constitutes a distinct whole and fulfils in effect the specific and essential functions of exempt fund management services, and should, as such, fall within the scope of the exemption. Clarity is, however, essential on this point in light of the recent reference to the ECJ in *GfBk Gesellschaft für Börsenkommunikation mbH* (Case C-275/11), although such reference should neither delay nor influence the decision of policymakers on this point.

The exclusion of supplies of trade-specific investment advice from the VAT exemption would result in significant additional costs for investment funds which rely on third party investment advisors to provide professional investment expertise for the benefit of its investors. See paragraph 1 above for why the outsourcing of such functions should be permitted.

#### **d. Points for clarification**

We believe that it is important that the new Directive and Regulation clarify: (i) the fact that equal treatment should apply to master/feeder structures or for services rendered to a dedicated fund or sub-fund; and (ii) the relationship between the outsourcing and fund management exemptions.<sup>1</sup>

### **5. Intermediary exemption**

We believe that it is important that the intermediation exemption continues to make reference to maintenance of contracts as in the current compromise text of the Directive. This is on the grounds that maintenance of a contract will include active intermediary services carried on during the life of a contract, which may be reimbursed by a trailer fee payable at a time after commencement of such contract (i.e. not merely an award of loyalty bonuses).

### **6. Risk that specific exclusions from exemption result in artificial splitting of composite supplies**

We believe that it is important to clarify that the fact that the supply of certain services may be specifically excluded from exemption under a particular heading does not prevent the supply from being exempt from VAT under general VAT principles (for example, where it forms part of a composite supply of which the principal elements are exempt). Such clarification is necessary to avert the risk that some Member States may try to argue that the exclusions are absolute with the effect that supplies are split artificially between core exempt and taxable, when the commercial reality is that the market is actually operating on a composite supply basis.

We have set out below two examples of where such risk may be of real concern:

#### **a. Fund distribution services**

Fund distribution services are an essential component of fund management, forming the “third pillar” of collective portfolio management pursuant to Annex II of the UCITS IV Directive (although the term used in the UCITS IV Directive is “*marketing*”). Such services will not, as a general rule, be the same as stand-alone advertising or marketing services, as the role of the distributor will actually be to sign investors up for a particular investment fund, i.e. the distributor will be acting as an intermediary between the fund and the investor.

The supply of core fund distribution services should, therefore, qualify for exemption pursuant to the intermediation exemption where the distributor is actively signing clients up for a particular investment fund (as is generally accepted under current law). The fact that “*advertising, marketing and other information services*” are, however, specifically stated to fall outside the scope of the VAT exemption creates the risk that some Member States may try to split such services out from the core exempt intermediary services.

---

<sup>1</sup> In this respect, we believe that: (a) the fund management exemption should only cover supplies of services which are exempt in their own right (i.e. irrespective of whether they are outsourced or not, or outsourced on their own or with other activities); and (b) the outsourcing exemption should cover the supply of any constituent element if exempt fund management services which does not fall within the fund management exemption but nonetheless in itself constitutes a distinct whole and fulfils in effect the specific and essential functions of exempt fund management services.

This point is absolutely critical for the funds industry, as the supply of distribution services will, as a general rule, form a very significant part of fund expenses.<sup>2</sup> If they were to become taxable, the objective behind the exemption for management of funds (as set out at paragraph 5 above) would be seriously undermined. In light of the importance of this issue, we believe that a specific statement is required which clarifies that fund distribution services may fall within the exemption for intermediary services notwithstanding any exclusion for stand-alone “*advertising, marketing and other information services*”.

#### **b. Global custody services**

Global custody services form an essential component of investment in global financial markets on the basis that segregation of investment management and custody of the underlying assets (typically financial assets either held electronically or in a cash account) is now generally established as a legal or regulatory requirement (for example, pursuant to the AIFMD or UCITS IV Directive).

The term “global custody” refers to a composite supply of three distinct services. The two principal elements of such supply are: (i) clearing and settlement services; and (ii) cash management services, both of which are VAT exempt where provided on a stand-alone basis. The ancillary element of such supply is physical safekeeping which is currently subject to VAT if separately supplied. Many Member States currently regard the provision of global custody services as distinct, specific and essential to the management of special investment funds and, as such, exempt from VAT pursuant to *Abbey National* principles. Global custody is not, however, specifically mentioned anywhere in the draft Directive or Regulation. As such, the fact that “safe custody” and “safe keeping” are specifically stated to fall outside the scope of the VAT exemption creates the risk that some Member States may try to split such services out from the core exempt services.

### **7. Financial transfer and financial deposit taking & account operation**

The definition of financial transfer is “the execution following an order for transmission of funds”. Looking at this legal approach from a business process perspective shows that this service is construed from more than the mere execution as it involves a considerable amount of preparatory work by a financial services operator to arrive at the point of execution. Customers or counterparties to the transfer are charged for the integral service of undertaking a transfer of, for example, funds. We would like clarification of what is in the scope of the exemption and therefore need to know what is meant by the word “execution” which is used extensively within the regulations under article 6 of FISC 123. It is our belief that execution should encompass the whole activity of undertaking the financial transfer and not just the final stage of completion of the transfer.

The reason this needs clarification is that the preparatory work for financial transfers is outsourced extensively across the industry while the final completion of the transfer in general remains with the financial institution for regulatory purposes. These outsourced distinct sections of the process still have to meet strict regulatory requirements. The assignee remains fully liable towards the regulators on these outsourced sections of the process. We therefore see that the preparatory work is integral and essential for the completion of a financial transfer and therefore requires clarification in both FISC 122 and FISC 123 that it is more than the final action of completion, otherwise there is a risk (similar to our points on outsourcing in section 1 above) that all these key preparatory functions would become subject to VAT when outsourced.

---

<sup>2</sup> According to the recent Strategic Insight report on *Fund Fees in Europe: Analyzing investment management fees, distribution fees, and operating expenses* (October 2011) commissioned by EFAMA, on average, European fund managers retain 42% of the total expense ratio, distributors are paid 41% of the total expense ratio and the balance of 17% is used for operating services such as custody, administration, transfer agency etc.

Account operation is defined as “the administration of monetary accounts for their holders”. We have concern with the reference to “their holders” as accounts can be managed for parties other than the account holder and we do not understand why this final part of the wording is required.

The term “account operation” is clearly intended to cover both the operation of transactions into and out of the account but additionally all of the elements surrounding the administration of the account itself, by virtue of the definition within FISC 122. In this respect, we welcome the reinsertion of points a) and b) in the regulations in FISC 123 which detail that the exemption covers the operation of the account, but would also request that greater clarity is given on what account administration could entail.