European Banking Federation

Chief Executive

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EBFR Ref. N° 0323

Email

Mr Maciej GRABOWSKI
Undersecretary of State
Ministry of Finance

Brussels, 20 September 2011

Subject*:** ***Comments of the European Banking Federation to the Polish Presidency compromise texts (FISC 98 and 99) as regards the VAT treatment of financial and insurance services
[EBF's ETI n°: 4722660838-23]

Dear Minister Grabowski,

Following our commitment to support the work towards modernizing and simplifying the complex VAT rules for financial and insurance services and securing a level playing field in the pan-EU market, the European Banking Federation (EBF)[1] welcomes the work undertaken by the Polish Presidency and the released compromise texts for a Council Directive (FISC 98) and Council Regulation (FISC 99) as regards the VAT treatment of financial and insurance services.

We have provided our comments on the four key areas of debate in the annex to this letter *(see D1531C-2011)*. This annex covers the following:

- Transfer of contract portfolios
- Outsourcing
- Management of investment funds
- Derivatives

Additionally, we have also made reference in the annex to two additional points regarding:

- Financial transfer
- Financial deposit taking and account operation

We hope you will find our comments useful for the improvement of the debate and would like to take the opportunity to offer once again our complete disposal to further discuss our inputs.

Yours sincerely,

Guido Ravoet

Enclosure: 1

[1] *Set up in 1960, the European Banking Federation is the voice of the European banking sector (EU & EFTA countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.*

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Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

EBF COMMENTS ON THE PROPOSED COMPROMISE TEXTS FISC 98 & 99 AS REGARDS THE VAT TREATMENT OF FINANCIAL AND INSURANCE SERVICES

1) Transfer of contract portfolios

We support the fact that the transfer of credit contracts is expressly included in the list of exemptions in article 5(1) of the proposed regulation. However, we have concerns that the scope of this article is too restrictive. We accept that, in the case of Swiss Re (C-242/08), the court found that the transfer of existing contracts of insurance did not, in itself, fall within any of the existing exemptions. However, to apply VAT to such transfers, which would be irrecoverable to the transferee due to the nature of the supplies to be made by it subsequent to the transfer, would significantly increase the cost of undertaking such sales of business and is likely to hinder the ability of the industry to restructure in this way.

In particular, it puts potential EU purchasers at a disadvantage, as VAT would be payable by an EU purchaser that is unlikely to be payable by a purchaser located outside the EU.

Therefore, we would welcome specific wording to clarify the position, and to amend the exemption so that it explicitly includes the transfer of existing contracts, where the supplies made under those contracts would themselves fall to be exempt. Additionally this helps alleviate the potential VAT charge on businesses in those Member States where transfer of a going concern pursuant to article 19 of the VAT directive 2006/112/EC is not available. Therefore we see this proposed exemption as equally relevant to contract portfolios in non-insurance financial sectors as to the insurance financial sector.

2) Outsourcing

We consider that the key objective for modernising the VAT treatment of outsourcing should be to ensure that businesses do not face increased VAT costs as a result of choosing to outsource certain functions rather than perform them in-house. That is, businesses should be able to structure their activities as they see fit without VAT creating a barrier.

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This is vital for the promotion of trade between businesses and the competitiveness of the EU. In particular, where a business makes exempt supplies and seeks to outsource some elements of those activities, the addition of VAT would create significant costs which, in many cases, would make the decision to outsource economically unviable.

Therefore, it is important that, where certain elements of an exempt supply are outsourced to a third party, the supplies made by the third party can also fall within the exemption on the understanding that the services provided are an essential part of that exempt supply from a business perspective. It is our view that each necessary step in the process is in fact a distinct section of the complete exempt supply.

The VAT as part of the supply should be independent of the length of the supply and distribution chain (case NV Nederlandse Spoorwegen 126/78 12-6-1979).

Furthermore, it is vital that the distinction between those outsourced services that fall within the exemption and those that do not is clear, to ensure neutrality and consistency of treatment between the Member States. For example, we would welcome greater clarity over some of the terms contained in ECJ rulings, such as "specific and essential". We do not consider that listing examples is the best way to achieve this. Rather, it would be more useful to clearly define the meaning of the wording in the directive or regulation. 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.

3) Management of investment funds

From the ongoing discussions that are taking place, it is clear that there is no consensus between the Member States on how widely the exemption for investment management should be drawn. We consider that these divergent positions are largely due to the fact that different financial centers have differing roles within the sector.

We consider that the scope of the exemption should follow from what the exemption aims to achieve. That is, the removal of a VAT burden on small investors wishing to make provision for the future. Taking this approach, we support the view that the exemption for fund management should be drawn such that it is not only maintained for the management of UCITS funds, but also includes the management of pension funds, as taxation should not be a barrier to individuals providing for their future.

However, as UCITS funds and pension funds can themselves invest in other funds, it is also important to ensure that those other funds are also within the scope of the exemption. Otherwise, the resulting VAT cost would cascade into the UCITS and pension funds, and create an unintended cost that is contrary to the intention of the exemption.

It is important to note here that the granting of an exemption in respect of investment management is not a VAT relief for the financial services industry. Rather, it prevents the passing on of VAT to end consumers by treating the financial service institution as the end consumer, thereby reducing prices for consumers. Treating all investment management as exempt would mean that the providers of these services would face increased VAT costs, as the VAT incurred in making these supplies would be restricted in its entirety. However, a wider exemption would reduce the administrative burden of the VAT accounting required and simplify the position as no distinction would be required based on the nature of the fund under management.

In terms of the proposed wording of the directive, we have concerns that the definition for an investment fund states that "…the *sole* object" is investment in securities, cash or other financial assets or in real estate. This should be replaced by "…the *main* object of which is…", similar to the definition for pension funds, in order to prevent future uncertainties. This should prevent the situation whereby a fund would cease to be treated as an "investment fund" by virtue of investing only a very small portion of its portfolio in assets that are not regarded as financial instruments according to the VAT directive.

The interaction between article 11(3) and article 13 of the proposed regulation is contradictory and should be clarified.

In addition, we consider that "strategic asset management", as listed in article 11(3) should qualify for "management", and therefore exemption, in its own right, without the need to have other elements combined to meet the requirements for exemption as currently drafted.

It is still not clear why investment advice is excluded from the exemption in article 11(4) of the proposed regulation. We would very much welcome clarification on the policy objectives involved, and in particular, an explanation of the distinction to be drawn between "management" and "advice".

4) 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.

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). This is on the basis that the proposed directive states that derivatives shall only be exempt if profits and losses are derived without any possibility of delivery, however, the implementing regulations state that derivatives must represent a "supply of services shall be distinct from the underlying transactions to which the services relate" so any possibility of delivery of an underlying should not be the determining factor for exemption. Therefore 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. 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.

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 the EBF has 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.

5) 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 99. 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 98 and FISC 99 that it is more than the final action of completion, otherwise there is a risk (similar to our points on outsourcing in section 2 above) that all these key preparatory functions would become subject to VAT when outsourced.

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 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 98. However, the regulations in FISC 99 no longer contain points a) and b) which detail that the exemption covers the operation of the account, but it has been considerably narrowed by these deletions to only encompass effecting change or setting up of standing orders/direct debits. We welcome the inclusion of the issuing of bank statements and confirming balances/transactions on the account but feel administration encompasses more than this and therefore we would request that points a) and b) are reinstated and greater clarity on what account administration could entail.