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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 NEW HUNGARIAN PRESIDENCY'S COMPROMISE TEXTS AS REGARDS THE VAT TREATMENT OF INSURANCE AND FINANCIAL SERVICES

Compromise Text for a Council Directive on the VAT Treatment of Insurance and Financial Services (FISC 53)

- *Article 135 (1) (b)*: According to the new wording of this article, the management of credit would only be VAT exempt if credit management is done by the person granting the credit. The EBF considers this is not an acceptable approach as the suggested definition, thus, implies a more narrow approach to management of credit than is the case according to current practice and would introduce sticking VAT where an exemption is most appropriate. This is especially of outmost importance if credit management services are rendered in connection with syndicated loans.

  Within the syndicated loans market, the convention is to appoint one of the banks in the syndicate to act as the Agent Bank, normally one of the leading banks arranging the facility of credit. The Agency banking services is a service paid for by the borrower but a service provided to the syndicate banks, who collectively provide the credit facility. The Agent Bank is entitled to a fee for the services rendered as it will be the primary contact point for the Borrower and the syndicate of banks and will also be the conduit through which payments of interest and repayment of principals amounts will flow.

  It would seem that the proposed change essentially results in the Agent Bank's services falling outside the exemption to the extent the services are rendered to other syndicate members. It is our view that the correct interpretation would be to regard these services as exempt on the grounds that as the Agent Bank is a member of the syndicate, it is de facto considered to be the person granting the credit.

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- *Article 135 (1) (f):*

  Financial deposit:

  We consider unnecessary the added requirement that the funds are being *'held for the depositor'* as it potentially excludes certain financial services offered in the normal course of business of financial institutions from the scope of the VAT exemption where the arrangement includes the monies being held potentially for a party other than the original depositor or for several different parties. If the addition is considered necessary, we believe it should be clarified that the depositor does not refer only to the party that initially made the deposit but to any party for whom the monies are being held.

  Account operation:

  In our view, the requirement that the administration of monetary accounts is to be '*for their holders'* it is an unnecessary restriction of the scope of the exemption. We therefore appeal for the removal of this added wording in order to have a broader view on this exemption so that no obstacles will be created for the developing European market for payments and credit granting.

- *Article 135 (1) (gb):*

  We understand from FISC 57 the technical work is still ongoing in respect of this sensitive issue and the discussion among Member States remains open to any solution. Nevertheless, we take this opportunity to share with you the opposition of the European banking industry to any solution that would incur irrecoverable VAT costs for the banks.

- *Article 135 (1) (gd):* A requirement has been added as part of the definition of the '*intermediation in insurance and financial transactions'* that the third party providing mediation 'brings the parties together and does what is necessary in order for the parties to enter into, maintain, renew, or alter a contract in insurance or financial transactions'. We have a key concern that the proposed compromise text narrows the existing exemption and will impact EU financial service providers. An explanation of why the two tier test has been introduced would be very beneficial as the insertion goes further than the existing intermediation exemption. An example of the type of transaction that could be caught is where a financial services company has negotiated some of the terms and pricing of an insurance or financial contract between the parties, but did not originally bring the parties together, (it may have been brought into the transaction at a later stage). Under the proposed wording the supply would potentially be taxable which cannot be the intent. This is not in line with the ECJ ruling in e.g. Volker Ludwig case (C-453/05) and CSC Financial Services (C-235/00). Therefore EBF considers that the previous wording *"… whose purpose is to do what is necessary …"* (see FISC 11 of 1 February 2011) is to be preferred as this wording is in line with the mentioned ECJ ruling.

- *Article 135 (1a):* The proposed wording is broadly in line with the jurisprudence of the ECJ. But, however, this wording can be interpreted differently by Member States as discussions have already shown.

The aim of modernizing the VAT rules for financial services is to improve legal certainty and to avoid additional costs caused by "hidden VAT" to ensure neutrality for financial institutions.

To improve legal certainty it is necessary to clarify under which conditions an outsourced financial service qualifies for exemption. There is a particular need to clarify vague terms requiring interpretation contained in ECJ rulings *("specific and essential")*. But this should not only be achieved by listing examples. It would be more useful to define the meaning of the wording in the directive or regulation. Furthermore, it needs to be clarified whether and, if so, under which conditions the service itself constitutes a distinct whole. These definitions are very important and should not be left to national legislation and national courts.

To ensure VAT neutrality and thus avoid additional costs for financial institutions it is necessary to take into account that the execution of outsourced financial services is nowadays a highly complex technical process (for example services of a data-processing centre). The mere fact that a service is rendered via electronic data processing does not necessarily preclude its exemption (see ECJ ruling in the case of SDC (C-2/95), no. 37). How a service is rendered – via electronic data processing, automatically or manually – is not decisive according to the ECJ. This should definitely be mentioned in the directive or regulation. Moreover it should also be mentioned that only the character of a service is important to qualify for exemption. The exemption should never depend on the person who renders or receives the service (functional approach, see no. 32, 33 and 58 of the SDC-ruling).

Putting the functional approach into specific terms means that the outsourcing of services related to regulatory compliance and identity verification, money laundering and anti-fraud checks also qualify for exemption (article 13 (1) (d) and (e) of the proposed regulation). These services are absolutely necessary and without any doubt specific to and essential for conducting payment services in particular. If the Single Euro Payments Area (SEPA) is to be promoted, it is of outmost importance to enable European financial institutions to outsource elements of the highly complex processing of payment services so that cost efficiencies can be realized without any additional VAT or administrative burden.

To ensure competiveness of European financial institutions it is absolutely necessary that the outsourcing of financial services which are of a more administrative and/or technical nature but which are, nevertheless, core financial services, i.e. form a collective whole and are specific and essential for the exempt financial service, is VAT exempt. Only this approach seems to be in line with ECJ's functional approach and furthermore ensures equal treatment between services provided in-house and services which are outsourced.

Compromise Text for a Council Regulation on the VAT Treatment of Insurance and Financial Services (FISC 54)

- *Article 6 (2) (b):* The EBF disagrees with the added provision which states that the definition of *financial transfers* shall not cover '*the electronic transport of messages between financial service providers while ensuring their integrity and security'*. As in

some Member States such services should be treated as tax exempt, we therefore suggest the removal of this added provision.

- *Article 11 (3):* We welcome the addition of the management of pension funds already defined in Article 135 (1)(gc) at the level of the Directive.

- *Article 11 (4) (f):* Investment advice is now given as an example of activities which cannot be covered by the VAT exemption. We are concerned about this given that the line between discretionary investment management services and investment advisory services can be very fine and there are situations where in practice the investment adviser's recommendations are, as a rule, followed although the investment adviser is required to seek confirmation from the board/management of the fund before going ahead with executing the transaction. The parties providing these types of services are the same as the parties who provide discretionary investment management services to funds. As in practice their activities are almost exactly the same in both scenarios, we feel it would be artificial to apply different VAT treatment depending on the factual existence of total discretion.

  Furthermore, we consider that the heading of '*investment advice'* is too wide in this context and suggest that this be amended to include the provision of '*investment advice to investment funds and pension funds'*. The term *'investment advice'* is used to refer to arrangements under which someone other than the party providing the advice is taking the final decision as to which assets to purchase, to sell or to hold within a fund. In this context the board of the fund (or the management company) receives the advice but takes the final decision. In this scenario, these services are arguably an essential part of the fund management. Where investment advice is included within a composite supply of exempt investment management services then such investment advice should still be part of an exempt supply.

- *Article 12 (1) (e):* The wording of Article 12(1)(e) providing an example of activities that are covered by the VAT exemption has been changed to rea*d 'negotiation on behalf of a party to a contract of the terms of that contract'* instead of *'supply of services involving negotiation on the conditions of the contract'*. We strongly object to the change of the wording, in particular the reference to the third party negotiating *on behalf of* a party to a contract. In several cases, the third party plays a crucial part in getting the parties to agree to certain terms of the contract but also the party he presents is present at and participates in the negotiations. The current wording might cause arguments that such activities should not be seen as falling within the scope of the VAT exemption.

- *Article 13 (6) and (7):* It is much welcome the inclusion in points 6 and 7 of examples of outsourcing situations regarding article 135(1)(e) (*financial transfers) and 135(1)(f) (transactions concerning financial deposit and account operation), which also includes the 'authorization and verification of payments'*. However, it is our opinion this exemption should amongst others also include - as a part of the authorization and *verificatio*n activities - outsourcing of services related to regulatory compliance, identity verification, money laundering and anti-fraud checks. Furthermore, the exemption should include outsourcing of processing, clearing and settlement (see also our comments above on article 135 (1a) of the proposed directive).