European Commission

COMBINED EVALUATION ROADMAP/INCEPTION IMPACT ASSESSMENT

This combined evaluation roadmap/Inception Impact Assessment aims to inform citizens and stakeholders about the Commission's work in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are, in particular, invited to provide views on the Commission's understanding of the current situation, problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	Review of the VAT rules for financial and insurance services
LEAD DG – RESPONSIBLE UNIT – AP NUMBER	TAXUD – C1
LIKELY TYPE OF INITIATIVE	Legislative package
INDICATIVE PLANNING	Q4/2021
ADDITIONAL INFORMATION	

This combined roadmap/Inception Impact Assessment is provided for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by this document, including its timing, are subject to change.

A. Context, Evaluation, Problem definition and Subsidiarity Check

Context [max 10 lines]

The VAT is a general consumption tax assessed on the value added to goods and services. It applies broadly to all goods and services sold for use or consumption in the European Union. The VAT Directive[1] lays down the rules on the VAT treatment of financial and insurance services, which are generally exempt. The reasons behind the exemption are multiple, but mostly related to the technical difficulty at that time to calculate the tax base as well as to the existence of other taxes. However, these rules were introduced in 1977 and have since become outdated. Not only do they lead to costs for financial and insurance operators, but they are also complex and difficult to apply.

As with any VAT exemption, suppliers of goods and services cannot deduct the VAT paid on their purchases needed in order to carry out their exempt supplies. For this reason, VAT often constitutes a cost for operators in that field and, in turn, their customers. Financial institutions have often attempted to alleviate this cost by means of existing instruments such as VAT groups (Article 11 of the VAT Directive) or – up until recently – cost-sharing arrangements (Article 132(1)(f) of the VAT Directive). The latter allow persons with exempt or non-taxable output supplies to reduce the VAT incurred on expenses by creating a common structure (cost-sharing group) from which they receive exempt input supplies.

The cost-sharing arrangements had been widely used by financial and insurance operators to offset the impact of their input VAT burden. In 2017, the Court of Justice of the European Union (CJEU) however overruled this practice, allowed by most Member States. Against the interpretation and application of Article 132(1)(f) of the VAT Directive by most Member States, the CJEU found that cost-sharing arrangements are not applicable to the financial and insurance sectors.

Apart from the implications of the recent jurisprudence, the VAT treatment of financial and insurance services raises other problems. The current rules are believed to be complex and difficult to apply in practice, notably given that they have not kept pace with the developments of new services in the financial industry (fintech services including services linked to cryptocurrencies and e-money). This seems to have led to increasing litigation before the CJEU, legal uncertainty, and high administrative and regulatory costs. Moreover, such rules are interpreted and applied inconsistently by Member States, which contributes to distortions within the EU and in exchanges with third countries.

The Commission proposed to review the rules on the VAT treatment of insurance and financial services

[1] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006).

already in 2007 through a legislative package which comprised a proposal for a Council Directive and a proposal for a Council Implementing Regulation[2]. However, the discussions in the Council ended up in a standstill and the proposals were withdrawn in 2016[3].

As announced in the Communication on an Action Plan for fair and simple taxation supporting the recovery strategy[4], the Commission will review the VAT rules for the financial and insurance services. This initiative is part of the Commission objective to simplify the life of taxpayers operating in the Single Market, which is one of the priorities laid down in the Political Guidelines for the present Commission[5].

Evaluation

The ongoing study will provide the factual basis for the evaluation the purpose of which is to assess the functioning of the current VAT rules for the financial and insurance services in a broader context of regulatory and indirect taxation rules. It will apply the criteria of effectiveness, efficiency, relevance, coherence and EU added value.

The evaluation will be based on the review of the most relevant legislative developments in the financial and insurance sectors since the financial crisis of 2007-2008. The economic data are collected in relation to the most recent year available for all the EU Member States and the UK. In addition, the evaluation will benefit from the comparative review of the VAT treatment of financial and insurance services in a number of relevant world jurisdictions such as United States, Switzerland, Singapore and Australia.

Problem the initiative aims to tackle

Problem 1: Lack of VAT neutrality

One of the most important principles of the VAT system is that of supply-chain neutrality, which means that the VAT treatment of goods and services should be the same regardless of the supply chain for producing them. This is ensured under the standard VAT regime through the right of deduction, which allows each business in a value chain to deduct the VAT incurred on intermediate consumption. An exemption regime, such as that applied to financial and insurance services, goes against the VAT neutrality, because it removes a right of deduction for inputs used for non-taxed activities. The VAT chain is broken and the cost of outsourced supplies increases in comparison with services produced in-house. This results in reduction of efficiency, influences business structures and produces competitive disadvantage compared to businesses supplying similar non-exempt services or to businesses operating outside the scope of VAT in third countries. This problem is particularly severe for businesses where high IT investments are needed (fintech).

Problem 2: Legal uncertainty and regulatory complexity

Legal uncertainty and regulatory complexity are closely related and linked to instability in the regulatory framework, gaps and a lack of clarity. Due to the nature of the exemption, and the diverse and quickly evolving types of financial services (fintech) as well as their regulatory context, a highly complex and constantly shifting set of provisions has been needed for the exemption to function. Combined with high levels of discretion for the Member States and complex and extensive CJEU case law, this has led to a considerable degree of legal uncertainty and complexity of the VAT rules applicable to insurance and financial services.

Basis for EU intervention (legal basis and subsidiarity check)

The current rules on VAT treatment of financial and insurance services do not reflect the reality of the sector and are applied inconsistently by the Member States. This is likely to contribute to distortions in the Internal Market and national measures alone are insufficient to modernise the rules and make their application more coherent across the EU. Moreover, as the VAT rules for financial and insurance services are laid down at EU level by a Directive, any initiative to modernise such VAT rules requires a proposal by the Commission to amend the existing VAT Directive. Hence, it is appropriate for the Commission to

[2] Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services (COM(2007) 747); and Proposal for a Council Regulation laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services (COM(2007) 746).

[3] OJ C 155, 30.4.2016, p. 3.

[4] Brussels,15.7.2020, COM (2020) 312 final.

[5] https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_en.pdf

propose a legislative action to improve the situation.

The legal basis is Article 113 of the Treaty on the Functioning of the European Union which states that *"The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition".*

B. Objectives and Policy options

The most important policy objective is to address the competitive disadvantage faced by financial and insurance operators. That is caused by irrecoverable VAT that they are facing because their services are exempt from VAT. The second objective relates to clarification of the VAT rules for the financial and insurance services and their further harmonisation to the extent possible in order to diminish currently existing discrepancies in the VAT treatment of the services in question across the EU.

Other policy objectives, closely linked to the ones above, are to provide a level playing field for EU businesses and in this way to contribute to the smooth functioning of the Internal Market and, in general, to contribute to the wider review of the VAT system with the aim of making it more robust and efficient.

For each of those policy objectives, the baseline scenario would be to leave the rules unchanged (status quo by which financial and insurance services would continue to be exempt from VAT). The following possible policy options will be considered in the impact assessment, without prejudice that alternative approaches may emerge through further public and stakeholder consultations.

The impact assessment could be structured around two main possible policy options: (i) to remove the existing exemption in order to tax financial and insurance services; or (ii) to keep the exemption, but to modify its scope through taxing only some types of services, e.g. fee-based as opposed to interest-based.

The removal of the exemption would not only free the suppliers of financial and insurance services from irrecoverable input VAT, but it would greatly simplify the VAT rules for the sector. Limiting the scope of the exemption would, on the other hand, probably allow to better address the risks of the impact of the review on consumer prices.

In this regard, several alternatives could be considered. For instance, to tax financial and insurance services (all or some types) at the standard rate, or to also allow for reduced rates while fixing a minimum rate.

In addition, the impact assessment will consider measures to address the distortive effect of the exemption, such as introduction of cost-sharing arrangements as a way to limit the problem of non-deductible input VAT and look at arrangements to address technical problems of taxing high-frequency trading (e.g. problems of calculating taxable amount, recording and following large numbers of transactions within a short time span) as well as at the place of supply rules to ensure taxation at destination.

Finally, a targeted option should be considered to make cost-sharing arrangements available to financial and insurance service providers, also when operating cross-border. While this option would not address many problems caused by the exemption, its advantages and disadvantages should be analysed.

C. Preliminary Assessment of Expected Impacts

The following preliminary assessments do not preclude the findings of the Impact Assessment the Commission will undertake.

Likely economic impacts

Most likely positive. The measures envisaged will assist in strengthening the Internal Market and enhancing competitiveness, among other elements – through removing fiscal barriers to outsourcing. Tax compliance should be made easier. A systemic change in the VAT rules for the sector may also have a positive impact on VAT revenues. The reform should contribute to creation of a more level playing field for the financial and insurance operators. Existing distortions linked to the exemption and its diversified application across the Member States should be reduced. A possible increase in cross-border commerce may provide greater choice for consumers and possibly have a positive effect on prices.

Likely social impacts

No direct impacts expected. Indirect impacts would be positive. The transparency, clarification, enhancement of legal certainty and facilitation of trade to be expected from this reform should stimulate growth and entrepreneurship. This could in turn have a positive impact on job creation.

Likely environmental impacts

No impacts expected.

Likely impacts on fundamental rights

No impacts expected.

Likely impacts on simplification and/or administrative burden

Most likely positive. One of the objectives of the review is clarification of the VAT rules for financial and insurance services, which should make compliance easier. Depending on the option followed, the taxpayers should get more clarity on the scope of taxation of their supplies, qualification of different types of services under the VAT rules, the treatment of the input VAT.

The relevant quantitative data is being collected through a study which is currently being carried out by an external contractor. The regulatory costs, benefits, savings, burden reduction and simplification potential will be identified and quantified.

D. Evidence base, Data collection and Better Regulation Instruments

Impact assessment

The Evaluation and Impact Assessment work has already commenced through data collection and analysis of options undertaken as part of an ongoing supporting study for the review of the VAT rules for financial and insurance services, in light of the existing regulatory and other indirect taxation rules.

The Evaluation and Impact Assessment will be carried out in parallel as a back-to-back exercise.

Evidence base and data collection

A study is underway to assist with the collection of the most comprehensive data possible, including available statistics and survey results and carrying out new surveys where possible and useful. The study will, amongst other things, produce an overview of the measures applied by all the Member States based on the provisions governing the VAT treatment of financial and insurance services. It will undertake an analysis of different categories of enterprises in relation to their activities and annual turnover and of the VAT revenues at stake in all the Member States. The Final Report of the study is due in September 2020.

In parallel to the study, the Commission is consulting Member States, stakeholders and VAT experts participating in the works of the Group on the Future of VAT and in the VAT Expert Group and is gathering feedback from several EU stakeholder associations through their dedicated contributions.

Consultation strategy

A consultation strategy will be prepared. The impact assessment is foreseen to be completed in the 3rd quarter of 2021 and the public consultation should therefore take place already in the 1st quarter of 2021 with the purpose of gathering the views of stakeholders on the current VAT provisions for financial and insurance sector and their application as well as on possible changes as regards these provisions. Its results will feed into the review. The consultation document will be made available on the DG TAXUD website: https://ec.europa.eu/taxation_customs/consultations-get-involved/tax-consultations_en. The Commission will inform stakeholders of this consultation through EU business representative organisations and by advising Member States.

A targeted consultation of stakeholders and tax administrations has taken place as part of the ongoing study on the exemption regime and the options for review. This involved in-depth interviews with business and Member States.

Will an Implementation plan be established?

While dependent on what will be adopted, it is expected that the implementation plan will include, implementing rules, guidelines for tax administrations/business and a communication plan. As with other VAT measures, Member States and stakeholders will be consulted on the implementation of the new rules through the VAT Committee and the VAT Expert Group or by way of seminars or workshops.