

Insurance and Financial Services VAT: Will a Reform Emerge by the End of 2021?

Kluwer International Tax Blog
November 3, 2020

Philippe Gamito, Gabrielle Galdino-Gläser (Baker McKenzie (London))

Please refer to this post as: *Philippe Gamito, Gabrielle Galdino-Gläser, 'Insurance and Financial Services VAT: Will a Reform Emerge by the End of 2021?'*; *Kluwer International Tax Blog, November 3 2020, <http://kluwertaxblog.com/2020/11/03/insurance-and-financial-services-vat-will-a-reform-emerge-by-the-end-of-2021/>*

State of affairs

Over the last two decades, eminent scholars and commentators have been highlighting the numerous issues arising from the current regime governing insurance and financial services as laid down in Article 135, 1, (a)-(g) of the Directive 2006/112/EC (“**VAT directive**”). From the lack of competitiveness of EU financial services businesses versus US counterparts as well as outsourcing bias to legal uncertainty and costly compliance obligations, the current VAT rules – or the lack of them –^[1] looks unsustainable over the long run.

Readers may well recall that in 2007 the Commission put forward legislative proposals^[2] as an attempt to tackle the long-term issues of the regime. These proposals extended the scope of the VAT exemptions and provided legal definitions whilst taking into account key case law from the Court of Justice of the European Union (“**CJEU**”). The proposals were abandoned in 2016 though as the discussions between Member States ended up in stalemate. That said, the approach taken by the Commission in 2007 was not necessarily satisfactory from a policy point of view insofar as it did not provide for a holistic review of the regime nor did it consider moving towards taxation. As De la Feria and Lockwood explained a decade ago already, the proposals would have given rise to considerable interpretative and qualification problems, resulting in even more complexity and legal uncertainty as the current regime.^[3]which is quite something to say.

In the meantime, in the absence of any legislative progress, the only way to address the shortcomings of the VAT regime rests with negative harmonisation through CJEU’s jurisprudence. From a legal perspective, this is however not good enough. First, judgments of the Court are based on a given set of facts, which leads to specific and concrete decisions as opposed to legislation, which is naturally general and abstract.^[4] This means that the Court could have decided differently in a slightly distinct given set of facts, resulting in challenges of applicability for taxpayers to “similar” but not identical situations and factual *minutiae*.^[5] It also results in tax administrations construing judgments differently with regard to the same legal provisions, thereby creating disruptions in the Single Market. Second, the central role of the Court in setting criteria to define the scope of legal provisions in respect of VAT exemptions is questionable. Although the constitutional role of CJEU has proven critical in many areas of EU law, the quasi-legislative role of the Court in respect of indirect taxation is not entirely critic-free.^[6] In the area of VAT law, it risks leaving taxpayers’ VAT position to depend solely on – sometimes “wholly” – new jurisprudential criteria that are not at all set in law. Glaring examples of this propensity are landmark cases such as *SDC*,^[7] *Skandia*,^[8] *Aviva*,^[9] or even, more recently, *Morgan Stanley*.^[10] In those judgments, the CJEU set new principles or new set of rules that define the scope of legal provisions laid down in the VAT directive, prompting dramatic consequences for taxpayers and authorities alike across the EU in terms of assessing VAT liability and input tax recovery issues.

Commission's plans for 2021: towards a draft proposal for a directive

Compared to other policies areas – capital and financial markets, financial supervision, banking union, etc. –^[11] the 40-year standstill as regards financial and insurance services VAT may come as a surprise. However, the reasons underpinning the impasse can be identified: the understandable difficulty for politicians to sell that VAT could be applied on basic financial services such as mortgages or payment transactions, the diverging interests of Member States whose financial services industry are larger, the inherent technical challenges of updating the regime, the lobby of certain businesses, etc.^[12] All of this suggested that no reform would take place any time soon, and this was certainly the view shared among practitioners and commentators.

Notwithstanding the unoptimistic mood in that regard, one has arguably been taken by surprise by both CJEU judgments and Brexit, which may well lead us to an unexpected swift reform. First, the judgments of the CJEU in 2017 as regards the cost sharing VAT exemption have concluded that it was not applicable to financial services transactions. This has shaken the financial services industry in countries like Luxembourg, the Netherlands, France and Belgium where cost-sharing structures were common. Although the technical basis for such conclusion by the CJEU is highly debatable,^[13] it has prompted the Group on the Future of VAT (“**GFV**”) and the VAT Expert Group (“**VEG**”) to reconsider the regime on VAT and financial and insurance services (right after the abovementioned 2007-proposals were withdrawn in 2016!). They met various times in 2018, 2019 and 2020. Their work focuses on five potential options of reform, ranging from full taxation of financial services (except insurance services) to taxing investment services only, and including optional or mandatory rates of deduction as well as new legal definitions.^[14] These options are to be considered in a study undertaken by an advisor whose results were expected in summer 2020. The authors are not aware of any results being published yet. Against this background, the Commission has recently announced a roadmap comprised of three phases. First, an “inception impact assessment” phase during which the Commission would like to receive feedback between 22 October and 19 November 2020. It will be taken into account by the Commission for further development and fine-tuning of the initiative. Second, a public consultation phase which is planned for the first quarter of 2021. The final phase will see the proposal for a directive emerge during the fourth quarter of 2021.^[15] Although this is probably an indicative timeline, it gives good hopes for a serious undertaking.

Second, the 2016-Brexit vote has taken all of us by surprise. After a few years of debate, it will actually take effect so that the UK will no longer be part of the EU as of 1 January 2021. From a financial services VAT point of view, this means that VAT exempt supplies made by UK banks and fund managers to EU counterparts and vice-versa will grant input tax recovery for those suppliers in line with Article 169 (c) of the VAT directive (assuming that no agreement between the UK and the EU decides otherwise). In addition, – as if the current rules were not already under pressure –, Brexit is likely to contribute to economic distortions even further. The UK, which accounts for a large part of the financial services output within the OECD,^[16] will be free to set its own rules, which is likely to mount additional pressure on EU lawmakers to move things forward.^[17] In this regard, the chancellor announced in March 2020 that a working group would be set up in order to review the UK VAT rules governing financial services. The direction of travel will largely depend on the policy angle taken by the main stakeholders (which, we expect, will be influenced by Brexit and the collateral damage resulting from the global pandemic), albeit “simplicity” should be the guiding principle for any UK reform.

Moreover, the UK government recently announced that UK courts of Appeal and the Supreme Court will be allowed to depart from retained EU case law from 1 January 2021.^[18] This may well result in UK courts deviating from restrictive CJEU judgments as regards financial services VAT exemptions in favour of more constructive and “industry-friendly” approaches for UK businesses. For instance, recent judgments in the payment sector – e.g. *DPAS*^[19] or *Cardpoint*^[20] – or, in the fund management industry, such as *Blackrock*,^[21] display the symptoms of a narrow interpretation that unfortunately results in a quasi-inapplicability of those VAT exemptions in practice. UK courts may therefore want to give those VAT exemptions another life by disregarding CJEU judgments.

What can we hope for?

It is good news that the Commission has decided to kick off a consultation process with stakeholders with the view to reforming the current rules. One can only hope that the Commission will carefully take into account the opinion of businesses as well as experts in order to maximise the potentialities of a new regime. From a policy perspective, it will be key to address the distortions that currently exist, whilst providing a legal framework that offers legal and fiscal certainty for businesses. There is no reason for indirect tax rules for financial and insurance services to be red lantern anymore in terms of legislative progress.

In the meantime, the CJEU will have to address important issues of VAT law in *Bank of China* (the follow up of the *Morgan Stanley* case) and *Danske Bank* (the follow up of the *Skandia* case) that will affect the financial and insurance industry. Before any legislative reform takes place at EU and/or UK level, we will thus continue to rely solely on CJEU and/or domestic jurisprudential developments as we have always done.

Philippe Gamito, Indirect Tax, Baker McKenzie (London), Msc, University of Oxford

Gabrielle Galdino-Gläser, Indirect Tax, Baker McKenzie (London), LL.M., King’s College London

[1] The absence of legal definitions and/or interpretative guidance means that taxpayers must solely rely on criteria established by the judiciary rather than by lawmakers.

[2] Proposal for a Council Directive amending the VAT directive on VAT as regards the treatment of insurance and financial services (COM(2007)747) and Proposal for a Council Regulation laying down implementing measures for VAT directive on VAT, as regards the treatment of insurance and financial services (COM(2007) 746).

[3] Rita de la Feria and Ben Lockwood, *Opting for Opting in? An Evaluation of the Commission’s Proposals for Reforming VAT for Financial Services* [2009] Oxford University, Centre for Business Taxation, 27.

[4] Rita de la Feria, *VAT and the EC Internal Market: the Shortcomings of Harmonisation* [2009] Oxford University, Centre for Business Taxation, Working Paper no. 29, 33.

[5] *Ibid.*, 33.

[6] *Ibid.*, 33; Also Philippe Gamito, *A Look Back at EU VAT Developments in 2019 Regarding Insurance and Financial Services: Part 1* [2020] 31 International VAT Monitor 4, 234.

[7] CJEU, *SDC*, C-2/95 dated 5 June 1997 regarding transactions in payment.

[8] CJEU, *Skandia America Corporation*, C-7/13 dated 17 September 2014 regarding VAT grouping.

[9] CJEU, *Aviva*, C-605/15 dated 21 September 2017 regarding cost sharing VAT exemption.

[10] CJEU, *Morgan Stanley*, C-165/17 dated 24 January 2019 regarding branches’ input tax recovery.

[11] MiFid II, PSD 2, Solvency II, etc.

[12] Christian Amand, *EU VAT and Financial Services: Which Rules, What Consequences and Which Possible Solutions?* [2019] 30 International VAT Monitor 5, 199.

[13] See inter alia Redmar Wolf, *The End of the Cost-Sharing as We Know It?* [2017] 28 International VAT Monitor 3; Philippe Gamito, *Is the Cost-Sharing Group for VAT Destined to Become A Historical Artefact for Financial Institutions?* [2017] 87 Tax Notes International (USA) 7, 702.

[14] Group on the Future of VAT, “VAT treatment of financial services – a reflection on possible options for review”, 25 May 2020, no. 98, taxud.c.1(2020)2654093, p. 6. (The VEG issued the exact same document on 29 April 2020).

[15] 1

See: <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12671-Review-of-the-VAT-rules-for-financial-and-insurance-services>.

[16] House of Commons, *Financial Services: contribution to the UK economy* [2019] Briefing Paper, no. 6193.

8.

[17] Philippe Gamito, *A Look Back at EU VAT Developments in 2019 Regarding Insurance and Financial Services: Part 2* [2020] 31 *International VAT Monitor* 5, 282.

[18] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/926811/departure-eu-case-law-uk-courts-tribunals-consultation-response.pdf.

[19] CJEU, *DPAS*, C-5/17 dated 25 July 2018.

[20] CJEU, *Cardpoint*, C-42/18 dated 3 October 2019.

[21] CJEU, *Blackrock*, C-231/19 dated 2 July 2020.