

## Accompanying document — VAT rules for financial and insurance services today and tomorrow

Insurance Europe welcomes the possibility to complement its response to the European Commission's consultation on the review of VAT rules for financial and insurance services, in order to provide additional background to its position.

The insurance industry welcomes the Commission's aim of reforming value-added taxation of financial services, which has been pending for a very long time. The VAT liability of financial services transactions continues to be governed by the VAT Directive that was implemented in 1977 and written even earlier. Insurance Europe takes the view that this Directive is outdated and not correctly applicable to modern financial services, as it puts financial services companies at a disadvantage compared to other economic operators.

Today, a fundamental reform is needed and feasible, and should have two aims: to reduce hidden VAT and to increase the possibilities of VAT reclaim for financial companies in general, and insurers in particular. Therefore we ask for a better integration of insurance services in the VAT system, with, in particular, a voluntary option to tax on the condition that insurance premium taxes and similar levies are abolished and that VAT exemption of health and life insurance, as well as contributions to pension schemes, is guaranteed.

### ■ The need for a reform

When implementing the VAT-regime in the late 1970s, the main issues with the taxation of insurance services were the computation of the tax base of financial services and the existing taxation of insurance services with insurance premium taxes. It was mainly for those two reasons that insurance services are exempt from VAT. However, at that time, the problem of hidden VAT seemed negligible in view of the still low tax rates in VAT and insurance premium taxes. Additionally, the value chain of insurance companies was largely vertically integrated and the outsourcing of functions was rather uncommon. Today, however, most member states levy insurance premium tax and sometimes the rate is as high as for VAT purposes (eg Germany at 19%). The hidden VAT has thus created a very large disadvantage for insurance companies. Not only with regard to externally purchased services, but also regarding internally supplied services within an insurance group (in particular, but not limited to cross border services which are mostly subject to VAT). At the same time, the possibilities of compensating for hidden VAT (eg by VAT grouping or cost-sharing...) have become increasingly difficult, particularly through case law (for instance by the recent decision of the ECJ in "Danske Bank" C-812/19). This increases the costs for insurance coverage as the costs of hidden VAT are ultimately borne by the customers. Next to the burden with hidden VAT, the bureaucratic burden of dealing with the effects of the VAT exemption is increasing for insurance companies with no end in sight.

### ■ The feasibility of a reform

Today, the value of the common market is also recognised for financial services. With an option to tax and, under these circumstances, the abolition of insurance premium taxes, a further step would be taken towards the desirable unification of the financial market. After all, the levying of insurance premium taxes is only partially harmonised. And, for the question of the taxable base of the insurance services, practicable solutions can certainly be developed. In case of doubt, reduced tax rates for VAT purposes could be implemented for instance. However, additional measures are also essential to ensure greater VAT neutrality in activities which would remain exempt.

Insurance Europe assumes that the Commission is aiming to reform VAT on financial services in order to design a stable tax system in the long term. If, however, the Commission has already concluded in the run-up to the political discussion that member states will not support such reform, far-reaching changes will have to be made to the existing system.

■ **Further comments**

Insurance Europe answered "Do not know" to Q38 *"To what extent do you agree or disagree with the following statement: The lack of input tax deduction is detrimental to the financial and insurance sector. It compels the sector to outsource services which are typically provided in-house, thus raising the costs."*

There is no direct link between the lack of input tax deduction and the outsourcing of input services and therefore it would not be possible to provide an answer to the question as it is currently formulated.

Insurance Europe would also like to add in relation to Q34 that, with regard to financial services, technology may help in the calculation of the taxable amount, but it should be noted that services have also become more complex, and the number of counterparties have multiplied as well as the number of transactions. Moreover, companies tend to use several IT systems that all contain relevant information for the VAT reporting. This has not really eased the VAT compliance.

Finally, Insurance Europe would also like to highlight that:

- Cost sharing groups should be allowed independent of the type of activities conducted by members of the group.
- Cost sharing should be available within company groups, eg through VAT grouping. It is important that cross border transactions are not treated less favorably than domestic transactions.
- Financial and insurance services operators ask for more clarity and legal certainty about the scope of the VAT exemptions to provide a more refined criteria and extensive list of exempt services.
- Policymaker should investigate on how the impact of non-deductible VAT on the cost of doing business of insurers can be limited. Besides the non-deductible VAT, IPT is charged on several insurance services in member states and rates tended to increase over the past few years.
- The introduction of option to tax should not be in addition to any IPTs to avoid double taxation and an increase of costs for insurance coverage for customers.
- The (partially) existing IPT exemption for life insurances, health insurance coverage and pension schemes and an option to tax property & casualty insurance should be reconsidered.
- The VAT Directive must be amended to make the option for VAT group treatment mandatory in every member state in order to avoid any distortion between financial operators in different countries.
- VAT-groups have been an efficient way to allow financial services to operate in groups instead of individual companies.
- The current wording of the VAT Directive uses undefined legal terms for integration ("closely bound by financial, economic and organisational links"). If the preconditions for VAT grouping is going to be defined and harmonized, it is important that the three links are interpreted in an holistic way<sup>1</sup>, looking at the economic and organizational reality and taking into account the specific circumstances of the entities looking to be grouped. The linking factors can exist in different forms depending on the circumstances and reflecting the economic reality. Therefore, not all links have to be fulfilled to the same extent and they don't need to have the same weight. The overall picture of the economic activity and the economic reality is decisive. Sometimes there won't be strong financial links but there will be strong organisational links. For mutual insurance companies it is not possible to fulfill the financial link if it is defined as a percentage (over 50%) of participation in the capital or in voting rights.

---

<sup>1</sup> (see VEG conclusions, taxud.c.1(2018)1668166 – VAT Expert Group VEG No 070 REV1)

- The VAT Directive should be amended to include the cross-border effect for VAT groups to avoid any distortion between financial operators located in different member states and in line with the ECJ ruling in Case C-386/14. VAT grouping rules to be eased and uniformed, in order to simplify the creation of VAT groups, allow requirements for VAT groupings to be met in practice by insurance companies and therefore establishing a level playing field across all member states.
- VAT obstacles to the arrangements needed for insurance business must be eliminated. These features should be determined by the nature of the service, rather than by the person providing it. To achieve a level playing field, outsourced services that are necessary to the insurance business must benefit from a VAT exemption.
- Mediation and distribution services should be VAT exempt to the same extent as the underlying financial transaction, including any cross-border component.
- Outsourcing of key processes, eg data centers, claims handling and similar, should be VAT exempt to the same extent as the underlying financial transactions, including any cross border component.

Insurance Europe is the European insurance and reinsurance federation. Through its 37 member bodies — the national insurance associations — it represents all types and sizes of insurance and reinsurance undertakings. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers pay out almost €1 000bn annually — or €2.7bn a day — in claims, directly employ nearly 950 000 people and invest over €10.4trn in the economy.