# VAT and FinTech 2/51/20

Partner and Head of Tax Practice, PwC
Latvia
Ilze Rauza

Recent years have seen new players rapidly entering the financial services market: FinTech companies. The name itself suggests that these companies are operating where financial services meet technology. FinTech companies are promoting and developing the banking business and are themselves becoming an alternative to traditional banking. This article explores some key VAT issues facing FinTech companies.

By FinTech we mean technology and business models – any innovative ideas that improve how financial services are supplied using new technological solutions or even create new services. FinTech services are supplied using apps and online portals, and receiving these services requires little or no personal interaction, so they have no borders.

FinTech companies aim to compete with the traditional methods for providing financial services and to make them available to a wider public.

The financial and insurance sector faced legal uncertainty about VAT treatment a long time before the advent of these latest business models, and the VAT treatment created an extra administrative burden. Plus, VAT affects costs that financial and insurance service providers incur.

FinTech services are very new compared to the VAT rules that were historically adopted for the existing financial and insurance services on the market. There was no new technology at that time.

Let us now look at key VAT questions facing FinTech companies.

## Is the service a taxable or an exempt supply?

This is the most important question because the answer to it will determine whether the FinTech company will charge VAT on its services and whether it can deduct any input tax it pays.

If the service is taxable, then input tax is fully deductible. If, however, the FinTech company has acquired goods and services for supplying either exempt financial services or any services that are outside the scope of VAT, then input tax is not deductible. Exempt financial services to third-country persons are an exception. If the company makes mixed supplies, i.e. taxable and exempt, the deduction of input tax comes down to keeping separate records of acquired goods and services or using a revenue ratio for input tax purposes. It is also possible to keep partially separate records or take a deduction approach that is different from the revenue method.

The question of whether the service is taxable is particularly important where the FinTech company serves financial institutions. Since financial institutions mainly supply exempt services and their right to deduct input tax is limited, output tax represents an extra cost.

To illustrate, here are choices that FinTech service providers have to make:

- The most important class of FinTech services in Latvia is co-financing services, peer-to-peer lending, and other fund-raising solutions. Do these services represent lending, intermediation

in lending, or IT services?
- Many FinTech companies are offering various apps for money transfers using mobile phones, watches or platforms. Do these services represent payment services or IT services? Payment services are exempt, but are these still payment services or rather taxable supplies of technical solutions?
- The third main class of FinTech companies are using distributed-ledger technology solutions that enable the registration of ownership of cash or other assets (e.g. cryptocurrency). Are these supplies outside the scope of VAT, exempt financial services, or taxable IT solutions?

Deciding whether a service is exempt comes down to whether it represents a distinct service that has the hallmarks of an exempt service. An example from our experience: a company's digital platform made it possible to put persons wanting to borrow in touch with persons willing to lend. The company provided the entire process from loan applications to granting loans and even further, i.e. it evaluated applications, prepared loan agreements, disbursed loans, administered repayments etc. The company collected service fees from the lenders and the borrowers. Only a court resolved the case by ruling that for VAT purposes the company's service is not an IT service supplied by a platform but rather a single compound service: intermediation in lending (an exempt supply).

## Does the supply involve a single compound service or several distinct, independent services?

The previous question has already outlined the next key problem that needs solving if a FinTech company offers several services to customers. Does the supply involve a single compound service or several independent services? This question is particularly important if any of the services is exempt. If the main service of a single compound service is exempt, or if several services form a single exempt service, then that service and any ancillary services are exempt. If, however, those are independent standalone services, then each has its own VAT treatment. So we need to evaluate the characteristic elements of each transaction and pay attention to the underlying contracts and the economic reality.

## Where is the service supplied?

Having customers outside Latvia raises the question of where the service is supplied, which determines which country will charge VAT and who will be responsible for paying it (whether the service requires the supplier to register abroad). To answer this question, we need to understand not only what this service is for VAT purposes but also who receives it. For example, if the service qualifies as an electronically supplied service and if it is supplied to individuals in different countries, there may be an obligation to account for VAT on the service in those countries (by registering abroad or through the MOSS scheme).

In summary, it is important to tackle your VAT issues and analyse your business from a VAT perspective before the State Revenue Service does the same thing. Making the wrong initial assumption about your chosen business model is likely to replicate mistakes that will heighten your tax risk (a three-year period is open to audit). This can lead to not only a financial loss but also a reputation damage. It is also important to note that if a company carries on a mixed sort of business, i.e. makes taxable and exempt supplies, the method used for deducting input tax significantly affects how much input tax can be recovered.