

Is VAT treatment in financial sector up for overhaul? 2/22/20



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The VAT treatment in the financial and insurance (“F&I”) sector prescribed by Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, which exempts F&I services without recovery of input tax on goods and services acquired for supplying those services, remains unchanged since 1977. Irrecoverable input tax causes extra cost to F&I players and their customers as well. Our experience suggests that the VAT treatment in the financial sector has been suffering from legal uncertainty and high administrative costs incurred in applying the VAT rules. The outdated definitions of services make it difficult for fintech companies to figure out how to claim an exemption. And there are no instruments to reduce the burden of irrecoverable input tax. This article explores whether the F&I sector is in for change.

How the EU is doing in terms of reducing the VAT burden on the F&I sector

The previous attempts to revise the VAT treatment rules had failed. The legislative package (amendments to the VAT Directive and its implementing Regulation) prepared in 2007 was taken off the agenda in 2016 because the discussions on this topic had not resulted in any legislative amendments.

So far the F&I sector has used instruments such as the VAT grouping¹ and – until recently, the independent group of persons² – for easing its VAT burden.

The VAT grouping rules provide for two or more closely related entities (in Latvia – companies within the same business group) to create a single taxable person so that transactions between group members become free of VAT. The rules on independent groups of persons allowed entities that were making exempt supplies or supplies outside the scope of VAT to reduce their cost of VAT on goods and services they acquired by entering into a cost sharing agreement for mutual supplies of services, which were free of VAT. The independent group of persons as a far more efficient instrument compared to the VAT grouping was widely used in the F&I sector, and the majority of member states had adopted it. In the wake of rulings C-326/15 DNB Banka AS and C-605/15 Aviva passed by the Court of Justice of the European Union (“CJEU”) on 21 September 2017, the member states were forced to amend their legislation after the CJEU flatly denied the use of a cost sharing agreement in the F&I sector. Latvia, too, has amended its rules on independent groups of persons to stop their use in the F&I sector with effect from 1 July 2019.

This has made the European Commission come back to the question of reducing the VAT burden on the F&I sector. In 2019 the Commission contracted an external consultancy for conducting a study to gather information that could serve as a basis for changing the VAT treatment in the F&I sector. The final report is due this September.

The Commission has stated that uncertainty, differences in the interpretation of VAT rules and the lack of consistency in applying them give rise to unnecessary tax competition and distortions not only across the EU but also with third countries.

The study will cover a much wider range of issues than what was considered during the previous attempts to amend the VAT treatment in the F&I sector. The study aims to assess the impact of the present VAT system on the F&I sector at national and EU level, considering how the industry rules have evolved, and to assess the impact of potential VAT amendments. This task involves not only analysing outputs, as was done before, but also seeking solutions to reduce the burden of irrecoverable input tax.

The study is expected to cover an impact assessment for the following options and their combinations:

1. The scope of exemption in the industry (service definitions, revising them in the light of developments in the F&I sector and new forms of services, adopting a definition of innovative services, and making recommendations for interpreting the definitions of exempt services);
2. Cancelling the exemption for the F&I sector, for certain financial sector services, or only for the financial sector, while keeping the exemption for the insurance sector (analysing the alternatives of charging a reduced or standard rate instead of an exemption);
3. Implementing a cost sharing agreement in the F&I sector;
4. An option to tax F&I services;
5. A fixed rate of input tax recovery (as an optional or a mandatory condition).

The Commission has asked the member states to offer their assessment of the present situation, make proposals for change, and provide any information that could help evaluate the alternatives.

We are looking forward to the report and more Commission initiatives aimed at tidying up the sector and reducing its VAT burden.

¹ Article 11 of the VAT directive

² Article 132(1)(f) of the VAT directive