Date

13 March 2008

Le Président

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Comptables
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Mr. Alexander Wiedow
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Dear Mr. Wiedow,
Dear Mr. Diemer,

Re: European Commission proposals dated 28 November 2007 regarding

Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services and

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

FeE (Fédération des Experts Comptables Européens – Federation of European Accountants)[1] represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States. With a combined membership of more than 500.000 professional accountants, FeE works in the public interest to contribute to a more efficient, transparent, and sustainable European economy.

FeE has considered the European Commission proposals dated 28 November 2007 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 (hereafter proposed directive) and 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 (hereafter proposed regulation) and the issues raised therein.

A. General comments

FeE welcomes the European Commission initiative to increase legal certainty concerning VAT in the area of insurance and financial services. We trust the initiative is appropriate to reduce administrative burdens for economic operators and national tax administrations and to reduce the impact of hidden VAT for insurance and financial services providers.

I. Overall concept

In particular, we highly appreciate the overall concept of a directive with provisions to be implemented in the Member States, accompanied by a regulation with directly applicable rules.

[1] www.fee.be

This concept is deemed to enhance the harmonisation of VAT in the area of insurance and financial services within the Member States.

We also highly appreciate the broad extension of the option to taxation on a transaction basis removing Member States discussion to allow VAT to be applied to certain financial services.

We believe that clarification of the interaction between supplies giving rise to a right to deduct, which can also be treated as not giving a right to deduct is essential. In our view where a supply can have both treatments potentially applied the treatment of giving a right to deduct should always prevail.

For harmonisation purposes it is also of utmost importance that the various language versions of EU legislation reflect the same content. We would like to draw the attention to the fact that some expressions in the proposed directive and the proposed regulation seem to be different in the various language versions, e.g. the expression “claims handling” in article 14 para. 1 point (c) of the regulation proposal in the English version does not correspond to the expressions used in the French and Danish versions. Thorough translation check of the various language versions and respective adjustments would be advisable.

Moreover, we recommend an adjustment to the numbering of the articles in the various language versions of the VAT Directive[2] into one common system to ensure an effective harmonisation of the tax rules and to simplify cross-border activities.

II. Case lists

We support the system of providing general definitions of the VAT exempt services in the directive and non-exhaustive lists of cases, which are covered by or excluded from the exemptions in the regulation.

There is, however, a risk that national tax authorities might try to interpret the case lists in the regulation as exclusive and in particular deny the VAT exemption for services not mentioned in these lists. The expression *at least* in articles 2 to 6 and 8 to 13 of the proposed regulation does in principle prohibit such interpretation. However, articles 14 to 20 of the proposed regulation do not contain the expression *at least*, and an amendment of the respective articles with an *at least* seems appropriate to ensure that the articles are fully comprehensible.

Furthermore, the case lists in the proposed regulation contain a number of specific technical terms which are difficult to understand for users, who are not experts in the insurance and financial services area, e.g. *retrocession* in article 2 of the proposed regulation might be understood as *reinsurance*. Legislation has to be simple and understandable in order that it is taken into account. Therefore, we suggest to use a more simple and general terminology.

III. Suggestions for amendments

From our point of view, the following VAT exemptions are not covered by the proposed directive and the proposed regulation and amendments in this regard should be taken into account:

- VAT exemption for the assignment of receivables in case the service is considered to be within the scope of VAT. At present, the VAT treatment of the assignment of receivables varies between Member States. In some Member States it is outside the scope of VAT, however, in other Member States it is within the scope of VAT but VAT exempt. For the latter case, the proposed directive and proposed regulation should contain the

[2] Directive 2006/112/EC on the common system of value added tax

clarification that this service is VAT exempt and that the assignment of receivables does not affect the tax point of the underlying transaction.

- VAT exemption for the management of pension organisations. At present, the management of pension organisations, e.g. of pension funds and pension organisations by certain professional groups such as lawyers, tax advisers or doctors is in principle VAT exempt. As there is no obvious reason to exclude the management of pension organisations in future from the VAT exemption, we suggest an amendment.

IV. Previous FeE comments

In this context, we also refer to the previous FeE comment letter[3] on the PwC Study to increase the Understanding of the Economic Effects of the VAT exemption for Financial and Insurance Services. We appreciate that some of our suggestions have been transposed into the proposed directive and proposed regulation.

B. Comments on specific articles

Please find herewith our comments on specific articles of the proposed directive and the proposed regulation.

I. Proposed directive

With the proposed directive, some articles of the VAT directive[4] will need to be amended. Our comments therefore refer to the numbers of the proposed future articles of the VAT directive.

1. Article 135 para. (1a): Outsourcing

The new article 135 para. 1a clarifies that insurance and financial services may also be provided by a subcontractor (outsourcing) and can be VAT exempt under certain requirements. The specified requirements – *supply of any constituent element of an insurance or financial service, which constitutes a distinct whole and has the specific and essential character of the exempt service* - reflect settled ECJ case law.

It is likely that insurance and financial services may also be provided by a subcontractor of the subcontractor and can be in total VAT exempt regardless of the various elements composing the distinct whole, e.g. AML checks.

- For clarification purposes, we suggest to add, *even if the element becomes consumed by another element.*

2. Article 135a para. (4): Financial deposit

Transactions concerning financial deposits are VAT exempt according to article 135 para. 1 point (c). Following the definition in article 135a para. (4), a financial deposit means a deposit of money held on behalf of the depositor who retains rights to the deposit, which must be repaid under the legal and contractual conditions applicable.

However, depending on the applicable law of the Member State, the service provider may gain ownership of the deposit of money and the depositor has a receivable against the service provider to the extent that the depositor does not retain any rights to the deposits itself.

[3] dated 16 February 2007.
[4] Directive 2006/112/EC on the common system of value added tax.

From our point of view, it would be sufficient for definition purposes that the deposits must be repaid under the legal and contractual conditions applicable.

- Therefore, we suggest deleting the expression *who retains rights to the deposits.*

3. Article 135a para. (9): Intermediation and sub-intermediation

According to article 135 para. 1 point (f), intermediation in insurance and financial transactions as referred to in points (a) to (e) is VAT exempt.

a) Intermediation in insurance and financial transactions

Only intermediation in insurance or financial transactions referred to in *points (a) to (e)* is VAT exempt. Therefore, intermediation of transactions related to real estate investment funds or to collective investments in movie pictures, ships or wind parks – if those are covered by the exemption in the first instance – seems to be excluded from the exemption.

- We suggest reconsidering the scope of the exemption of intermediation.

b) Sub-intermediation

Following the definition in article 135a para. (9), the supply of services must be *rendered to and remunerated by a contractual party.*

The definition therefore excludes sub-intermediation, where the sub-intermediary renders the services to the intermediary and not to a contractual party.

From our point of view, this exclusion of sub-intermediation is not in line with

- the principle that the exemptions should be linked to the nature of the services concerned and not to the persons supplying them,[5]
- ECJ case law[6]. The respective ECJ judgment was related to the interpretation of *negotiation of credit.* The ECJ ruled that the recognition of an exempt service cannot necessarily depend on the existence of a contractual link between the provider of the negotiation service and one of the parties to the credit agreement. The ECJ further clearly stated that exempted transactions are defined in terms of the nature of the services provided and not in terms of the person supplying or receiving the service. The ECJ pointed out that it follows from the principle of fiscal neutrality that operators must be able to chose the form of organisation which best suits them without running the risk of having their operations excluded from the exemption.

Furthermore, it does not correspond with article 10 of the proposed regulation, where a distinct act of mediation requires that the intermediary has the authority to bind the supplier or the customer of the exempt insurance or financial service but no reference to the remuneration is made.

- Since we doubt that sub-intermediation can be subsumed under another article of the proposed directive and in order to meet the principles stated in the proposed directive itself, the rules laid down in the proposed regulation as well as the general principle of

[5] Point (3) of the preamble of the proposal directive.
[6] ECJ dated 21 June 2007, C-453/05, Volker Ludwig.

fiscal neutrality, we suggest to fundamentally reconsider the wording of this article of the proposed directive.

4. Article 135a para. (10): Investment funds

According to article 135 para. 1 point (g), the management of investment funds is VAT exempt. Investment funds are defined in article 135a para. (10) as undertakings for collective investment in the exempted financial instruments referred to in points (a) to (e) of article 135 (1) and in real estate.

However, collective investments may as well be made in assets such as ships or containers or in projects such as movies. Such investments do not seem to be covered by the definition.

- We suggest providing a clarification in this regard.

5. Article 137a: Option for taxation

We welcome that a right of option for taxation shall be codified, which is deemed to reduce the impact of hidden VAT for insurance and financial services providers and improve the competitiveness of the EU financial sector.

However, we have concerns that the implementation of this right is left to the Member States and that Member States are only obliged to do so from 1 January 2012 onwards.

In order to enhance the harmonisation of VAT in the area of insurance and financial services within the Member States, the right of option for taxation should not depend upon the implementation and interpretation by the Member States. Furthermore, it should not be postponed until 1 January 2012 but be introduced as a common system from the beginning.

- Therefore, we recommend deleting article 137a completely from the proposed directive. Instead, the content of article 137a no. 1 should be modified (deletion of *from 1 January 2012*) and included in the proposed regulation.

Furthermore, we would like to draw your attention to the following issues which in our view require clarification:

In case a supplier, resident in one Member State, renders insurance or financial services to a taxable person resident in another Member State, the supplier can opt for taxation. In principle, the recipient of the supply becomes the taxpayer, due to the application of the reverse charge system. There is a risk that the recipient considers the supply as VAT exempt and refrains from declaring the respective VAT and – in case he is not entitled to deduct input VAT – from paying the respective VAT.

Therefore, we suggest the following amendment:

- *The option binds the recipient in the case where the reverse charge applies. Member States control the VAT declaration and – where applicable the VAT payment – in this case.*

Moreover, the tax base for certain supplies of insurance and financial services is difficult to determine. In principle, tax base for a taxable supply of services is the consideration. However, for certain supplies of insurance and financial services, this consideration may be the margin.

In order to clarify, that the taxable person may also opt for taxation for the supply of such services, we suggest the following amendment:

- *The right of option for taxation is not excluded in the case where the margin is the tax base for a supply of insurance or financial services.*

6. Article 137b: Cost-sharing group

We welcome the introduction of a cost-sharing group, which allows economic operators to pool investments and re-distribute the costs of these investments VAT exempt from the group to its members.

According to article 137b of the proposed directive, services supplied by a group of taxable persons to members of the group can be VAT exempt under certain conditions. In this regard, we would like to point out the following concerns:

One condition is that *the group and all its members are established or resident in the Member States*, article 137b para. (1) of the proposed directive. We assume that the exemption is not applicable if entities or branches of the group are established or resident outside the EU.

- Since there is no obvious reason for this exclusion, we suggest amending a clarification, why members of the cost-sharing group have to be established or resident in the EU.

Another condition is that members of the group supply *VAT exempt insurance or financial services* or other services in respect of which they are not taxable persons, article 137b para. (3). However, it is possible that members of the group supply both VAT exempt insurance and financial services and other services, which may be taxable or VAT exempt.

- Therefore, we suggest a clarification to the wording that *the additional supply of other – taxable or VAT exempt – services does not exclude the application of the rules for the cost-sharing group.*

A further condition is that the services are supplied by the group only to its members and are *necessary* to allow members to supply VAT exempt insurance or financial services, article 137b para. (4). From our point of view, a further definition of necessary services is required in order to enable the group and its members to respectively identify them. In particular, the case lists in the proposed regulation have to be considered in this regard. For example, services relating to regulatory compliance are in principle necessary to carry out insurance and/or financial services, since otherwise the license can be revoked. These services are however explicitly excluded from the VAT exemption for management of investment funds according to article 12 para. 2 point (c) of the proposed regulation. Furthermore, it has to be taken into account that the identification of necessary services implies practical and logistic challenges for the group and for its members.

- Therefore, we suggest that you reconsider the scope and wording of this provision and – where appropriate – make and amendment if *necessary*.

Another condition is that the group claims from its members only the *exact reimbursement* of their share of the joint expenses, excluding any *transfer-pricing adjustments* made for the purposes of direct taxation. We assume that “transfer-pricing adjustment” does not mean that a mark-up prevents the exemption from applying. Furthermore, we would like to draw your attention to the fact that members may not exactly reimburse an amount but contribute in kind or in share capital or interest in a partnership.

- Therefore, we suggest that the wording be amended in this regard.

7. Article 174 para. 2 point (c): Calculation of deductible proportion

The amount of turnover attributable to financial transactions as referred to in points (b) to (g) of article 135 (1) in so far as those transactions are incidental shall be excluded from the calculation of the deductible proportion.

- We are aware that this is not a new issue, however, suggest to replace (b) to (g) with *(a) to (g)*, since there is no obvious reason to exclude insurance services.

II. Proposed regulation

1. Article 2 point (3): Health insurance

The definition of insurance and reinsurance will – amongst others – cover health insurance.

We assume that health insurance does in principle mean insurance related to any kind of medical care. However, health insurance generally covers a wide range of services, which are not necessarily related to medical care. For example, hospital daily benefits insurance covers the gap between regular net income and the reduced amount paid by the social security institutions after a certain time of illness. It may however be considered as a special kind of health insurance.

- Therefore, the definition might require further clarification.

2. Article 3: Granting of credit

The definition of the granting of credit will cover at least the provision of loans, whether syndicated or not, article 3 para. 1 point (a). We assume that this definition already includes loans secured on real property and loans secured on movable property so that these loans do not need to be mentioned separately in article 3 para. 1 point (b) and (c). Moreover, if mentioned separately, those points create uncertainty, whether loans secured by intangible property such as intellectual property are covered since such loans are not explicitly mentioned.

- Therefore, we suggest to delete points (b) and (c) for simplification and clarification purposes.

Furthermore, the definition will include loans granted as a financing element in conjunction with the supply of goods or services provided the financing element is not an integral part of the consideration. The definition is unclear as it does not mention which party grants the loan. The reference to the consideration in principle implies that the recipient of the supply of goods or services grants the loan. However, the reference to the financing element in conjunction with the supply implies that the supplier of goods or services or a third party grants the loan.

- Therefore, we suggest clarifying the wording to be clear as to which party grants the loan – the supplier, the recipient or a third party.

Moreover, the case list does not enumerate loans in kind. Since article 135a point (2) of the directive proposal defines granting of credit as lending of money or the promise to lend money, we assume that loans in kind are not VAT exempt.

- We suggest clarifying the wording in this regard.

According to article 3 para. 2 point (a), the definition of the “granting of credit” shall not cover agreements under which payment by instalments or an extended period for payment is provided for in respect of the supply of goods or services.

However, payments by instalments or an extended period for payment may be granted for a separate consideration. We assume that the services then have to be considered as loans and are VAT exempt according to article 3 para. 1 point (a).

- Therefore, we suggest clarifying the wording in this regard.

3. Article 4: Guaranteeing of debts

According to article 4 para. 1, the definition of "guaranteeing of debts" will cover at least the provision of credit default swaps and customs bonds.

From our point of view, this list of examples, which are covered by the exemption is very short and might encourage a restrictive interpretation of the definition provided for in article 135a point (3) of the proposed directive.

- A clarification of the reasons for the short list of examples could be included in the preamble to the regulation in order to avoid such a restrictive interpretation.

According to article 4 para. 2 point (b), the definition of guaranteeing of debts will not cover the handing over of assets to be used as collateral for a debt not resulting from the granting of credit.

From our point of view, debts not resulting from the granting of credit may occur in the agricultural sector, e.g. where farmers buy seed and pay for it after the harvest. A third party might provide an asset as collateral in this regard on receipt of consideration from the farmer. We assume that the service provided by the third party would be covered by article 4 para. 2 point (b) and therefore not be VAT exempt.

- We suggest to reconsider the scope of this provision and to clarify the wording where appropriate.

4. Article 5 para. 1: Financial deposit

We would like to draw your attention to the following issue:

Life insurance used as security does not in principle cover a risk and can therefore not be subsumed under the insurance definition. However, such life insurance does in principle correspond to a financial deposit.

- Therefore we suggest amending article 5 para. 1 of the proposed regulation with *(i) life insurance used as security.*

5. Article 6: Account operation

Account operation is VAT exempt according to article 135 para. 1 point (c) of the proposed directive and defined as *operation of a monetary account for a customer* in article 135 a point (5) of the proposed directive.

In contrast, the example in article 6 point (3) of the proposed regulation refers to a *bank account* and thus restricts this exemption to accounts operated by banks. However, also insurance companies may also operate accounts.

- Since the exemptions will be linked to the nature of the services concerned and not to the persons supplying them,[7] we suggest to replace *bank account* with *insurance or bank account* or to use a more general description.

According to article 6 point (7), “account operation” will cover the access to and the operation of internet and telephone banking.

From our point of view, this provision may as well cover the services of the telecommunications provider, whose lines enable internet and telephone banking.

- In case such interpretation is being excluded, we suggest clarifying the wording.

According to article 6 point (9), “account operation” will cover the clearance and the transfer of funds between financial operators. Clearance and transfer require authorisation that can be supplied separately.

- Therefore, we suggest amending article 6 point (9) to *and the respective authorisation*.

6. Article 7 point (1)/article 135a para (6)[8] of the proposed directive: Exchange of currency – normally (not) used as legal tender

Exchange of currency is VAT exempt according to article 135 para. 1 point (d) of the proposed directive. It is defined in article 135a para (6) of the proposed directive as a supply of services whereby a person changes the currency of bank notes or coins *normally used as legal tender*. According to article 7 point (1) of the proposed regulation the definition will not cover transactions involving collectors’ items, *normally not used as legal tender*.

From our point of view, bank notes or coins may either be used as legal tender in a Member State or not, depending on the respective currency rules. The expression *normally* is thus not appropriate for definition purposes.

- Therefore, we suggest deleting the expression *normally* in article 135a para (6) of the proposed directive and in article 7 point (1) of the proposed regulation.

7. Article 10: Distinct act of mediation

According to article 135 para. 1 point (f) of the proposed directive, intermediation in insurance and financial transactions as referred to in points (a) to (e) is VAT exempt. The intermediation has to be a distinct act of mediation, article 135a point (9) of the proposed directive.

According to article 10 para. 1 point (b) of the proposed regulation, an activity constitutes a distinct act of mediation where the activity *may result* in the creation, continuation, alteration or extinction of parties’ rights and obligations in respect of an exempt insurance or financial service.

Following the expression *may result*, we assume that the intermediation service is VAT exempt even if the main transaction is not carried out. Therefore, the entire spectrum of activities of investment banks such as targeting, negotiation and assistance in funding may in principle be VAT exempt.

- In case such interpretation is being excluded, we suggest clarifying the wording.

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[7] Point (3) of the preamble of the proposal directive
[8] This article should be reviewed for banks notes issued in Scotland and Northern Ireland

According to article 10 para. 2, a service shall not constitute a distinct act of mediation in situations other than those covered by paragraph 1, where it is standardised in such a way that a person may provide it on the basis of prior instructions.

From our point of view, this provision allows the interpretation that a service described in paragraph 1 which is standardised does constitute a distinct act of mediation.

- In case such interpretation is being excluded, we suggest clarifying the wording.

8. Article 11 para. 1 point (a): Intermediation – negotiation on the conditions

The definition of intermediation in insurance and financial transactions will cover the supply of services involving negotiation on the conditions of the product.

From our point of view, this provision may as well cover negotiation of the conditions of an existing debt. However, intermediation does in principle require bringing together the parties of a not yet existing contract.

- Therefore, we suggest clarifying the wording.

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We would be pleased to discuss any aspect of this letter you may wish to raise with us.

Yours sincerely,

Jacques Potdevin
President