VAT
AND FINANCIAL SERVICES

Christian Amand
ERA
Academy of European Law, Trier
28 November 2019

EU VAT

- EU VAT = tax on consumption
  exactly proportionnal to the price
  whatever the place of production
  - VAT is collected on each transaction at each stage of the production
    - Method of collection is a monitoring tool, but not the core characteristic of the EU VAT

- But what is « consumption » ?
  - = what is not used for production
    - The purpose of the EU VAT is not to tax production in order to avoid discriminations between producers established in different Member States of a Common Market (1967)

Financial Services

- Intermediation in money, time and risk
  - Contracts
- Technology of finance is basic
  - May be produced everywhere
- Payment for such services may be
  - Specific commissions
  - A portion of the margin of the service supplied
    - Impossible to individualize the price of a service
    - The service and the price is expressed in money
      - If the the price is a percentage of the cost of production, the customer would know that is the possible benefit and the supplier would have no possibility to negotiate the price

Customers of financial services

– Business
  - VAT is neutral
  - VAT exemptions are an additionnal cost (ie the non deductible VAT included in the price of the VAT exempt supply)

– Non-business ie households <u>and</u> governments (incl. organisations financed by Governments)
  - VAT is a cost
  - Political Incentive to VAT exemptions

xirius

History

- Proposal of a Second VAT Directive (1965)
  - Taxation of Banking services
  - Studies about taxation of Insurance services
    - Directive let freedom to Member States as far it had no impact on the Single market

- Sixth VAT Directive (1977)
  - VAT exemptions (no right of deduction) of some « objective services »
    - ≠ activities of some business such as banks and insurance services
  - Out of the VAT scope (no right of deduction)

  - Taxation (with right of deduction)
  - Option to tax (not harmonized)
  - Zero-rating transactions (with right o deduction) with non EU Member States

  - Co-existence of specific national taxes

x i r i u s

- 1996 Poddar Study : Cashflow taxation of each individual operation

- 2007 Proposal for a Directive amending the EU VAT Directive
  - Difficulty of definition of financial services

- 2020 ?
  - New study……

A worlwide issue,

as old as the VAT …

- Impossible to determine the taxable base of many financial services individually

- Possible to determine the taxable base at business level,periodically
  - Determination of the taxable base in relation to supplies of financial services to non EU recipients
    - Case C- 172/96, *First National Chicago Bank*
      - Overall result ie gross margin of transactions over a given period of time (total financial revenue – total financial expenses)
      - Similar issue on Gambling, Case C-38/93, *Glawe*
        - » But only private individuals are consuming gambling services (with the exception of derivatives)

xirius

Consequences of the current systems

- Taxation of production
- Delocalization in low taxed jurisdictions
  - SDC Case
    - Arthur Andersen case
  - FCE Bank Case
  - BBL Case
  - Skandia Case
- Non taxation
- High cost of management
- Discriminations
  - Different distibution costs is insurance contracts are commercialized by insureance companies or banks

- Exemption / out of the VAT scope
  - = taxation of costs
    - ie incentive to outsource financial services where the VAT costs are limited
    - Revenue attributed to countries having succeeded to attract financial business

Example

- Payment services are VAT exempt (PayPal, hipay, Neteller, paysafe, etc)

- Payment operator
  - is established in Belgium
  - has let the option to tax payment services in Belgium
  - deducts input VAT

- Customer is non business, established in Luxembourg
  - Place of supply Belgium, Belgian VAT charged

- Customer is a business, established in Luxembourg
  - Place of supply : Luxembourg
  - Payement services are VAT exempt (no reverse charge in Luxembourg)
    - Quid if the customer in Luxembourg has no right of deduction of input VAT ?

Supplier established outside of EU

- Supplier of financial services established outside of EU
  - No VAT or full deduction of input VAT

- Customer established in the EU
  - Service VAT exempt in the EU

➢ *If the supplier would have been established in the EU, he would have supported non deductible input VAT on its costs*

Theoretical Alternatives to the current system

- Taxation
  - Distinction taxable transactions with other transactions ?
  - Difficulty to determine the taxable base
    - Even when it is possible, is it appropriate to show the taxable base ?

- Option to tax offered to business in some Member States
  - Absence of harmonisation, and therefore non taxation

- Zero-rating *(with right of deduction of input VAT)*

  = subsidy to production when applicable to services national customers

- Other methods that have never been implemented in practice such as cashflow system, modified reverse charge etc.

Requirements for a change

According to the recent litterature

- Eliminate
  - Business over-taxation
  - Consumer (households and public autorities) under-taxation
  - distinction between taxable and VAT exempt
- Full deduction of input VAT for business
- Positive and efficient VAT collection
  - But VAT is a tax on « non production »
- ***Feasiblity !*** *(ie cost of implementation)*
- Tax levied « Transaction by transaction basis » (???)
  - But is this the essential characteristic of the EU VAT?

Suggestion

- Zero rating B2B transactions supplied by regulated financial institutions only
  - ≠ reverse charge
  - Grant a full right of deduction of input VAT on the costs

- Zero rating B2G (including organisations funded by taxes) transactions by regulated financial institutions

- Taxation – a reduced VAT rate - of the margin on B2C transactions
  - The customer does not need to know the amount of VAT charged because he has no right to deduct input VAT
  - Periodical and global determination of the taxable base at the level of the financial institution in a specific country

Benefits of zero-rating Financial Services B2B and B2G

- No incentive to delocalize production of financial services outside the EU
- Reduction of costs of management for financial institutions (M&A, transfer pricing, deduction input VAT, etc)
- Additionnal revenue for EU Member States

Christian Amand
Tax Lawyer
Av Tedesco 7
1160 BRUSSELS
Tél. : + 32 2 663 14 55
E-mail: ca@xirius.be
Website: http://www.xirius.be