European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

Brussels, 8th June 2006

Comments by the EACB regarding The Commission's Consultation Paper on modernising Value Added Tax obligations for financial services and insurance

GENERAL REMARKS:

The European Association of Cooperative Banks (EACB) agrees with the European Commission that there is an urgent need in finding a solution to the current treatment of financial services under the 6th VAT Directive.

We approve of the pragmatic approach by the Commission to amend the existing Directive text to reflect to address its most important short-comings with regard to financial services within the existing VAT framework, such as in particular the dissuasive effect of non-recoverable input VAT on outsourcing of services.

The EACB considers that the most important problem areas with regard to the turnover taxation of financial services in Europe appear to have already been referred to in the Consultation Paper. In our view, the following areas need to be highlighted:

a) In general terms, when revising the provisions, importance must be attached to not increasing the administrative burden for the companies concerned or for the administration. For the companies, tax risk arising from legal uncertainties needs to be reduced through practical and clear provisions that are as easily understandable as possible.

Rue de l'Industrie 26-38, Box 9 • B-1040 Brussels
Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • e-mail :
secretariat@eurocoopbanks.coop

b) An adequately selective definition of the financial services exempt from taxation is required to avoid or at least substantially reduce the repeatedly occurring arguments between companies and the national revenue authorities over delimitation matters. The extent of the tax exemption needs to be dealt with in more specific terms, especially in relation to the outsourcing of services or elements of services to third parties and be made manageable in practice on the basis of general delimitation criteria.

c) The requirements for forming a VAT body among different enterprises are implemented differently in the Member States, leading to distortions in competition within the Internal Market. Some Member States have chosen not to implement VAT groups on their territory, others have done so, but do not allow cooperative banking networks to form such VAT groups. Therefore, in the interest of a level playing field for all actors in the European Internal Market for financial services, it should be mandatory for Member States to provide the VAT Group option to all forms of companies, cooperatives included.

d) The division of non-directly allocatable input tax into deductible and non-deductible parts is handled very differently in the Member States. The stipulations of the directive should be worded in such an unambiguous manner as to ensure extensively homogeneous and, therefore, competitively neutral implementation at national level. Companies should, as far as possible, have a choice between the options of division according to fixed specification, an individual input tax formula or an allocation based on an margin calculation method to improve the pro-rata method.

The underlying idea of the margin calculation is that the relation of VAT-deductible income to total income (i.e. the margin) will serve as a way of determining the basis for the VAT pro-rata allocation to particular products and services. In this way, an individual VAT-allocation can be determined for each business field. The margin calculation could be roughly presented as follows:

$$\text{Input-VAT deduction (\%)} = \frac{\text{Income subject to input-VAT deduction}}{\text{Total income}}$$

DETAILED REMARKS:

The Consultation Paper first sets out different technical solutions for the problem areas outlined – in addition to the modernisation of the definition of tax-exempt services. We would like to make the following comments and additional suggestions:

Section 4.2.1.: Zero tax rating

The EACB sees Zero tax rating for the delivery of goods and services between businesses as a workable solution to solve the bank-specific VAT-problems.

However, drawing on the previous experiences in some Member States, the application of a zero-rating system should be as simple as possible to avoid additional administrative burden for the financial sector.

If zero-rating were not to be retained in the eventual amendments, we would suggest that alternative solutions with similar effects were to be taken into consideration.

Section 4.2.2.: Extending the scope of exemptions

In our view, this approach is not suited to gaining control over the problems of the limited deduction of input tax, etc. We agree with the remarks in the Consultation Paper that a practically manageable definition and delimitation of the privileged passing-on of services cannot be formulated with the necessary clarity. The definition must, accordingly, not be linked to the person of the party providing the service or the recipient of the service or the legal relations between them but, rather, to the content of the services provided. Only in this way can the definition also remain sufficiently flexible in the case of changes.

However, the simple codification in a Regulation of the principles stated by the ECJ does not appear sufficient to this day to produce sufficient legal certainty. (See also our response to section 4.4. – Definition of tax-exempt services) Therefore, more detailed guidance is necessary to define what is to be considered as a financial service, according to its underlying purpose and its economic substance. Uncertainty as to how to define a financial service will lead to differing interpretations from Member State to Member State and result in new

distortions of competition. In the end, any service received by a bank which forms a necessary or indispensable part of an output financial service should be exempted.

Section 4.2.3.: Uniform limited input credit option

In our view, the disadvantages already outlined in the Consultation Paper predominate with regard to this solution. The advantage provided by the additional deduction of input tax would be offset by the administrative and delimitation cost required. Just as the delimitation between tax-exempt and taxable sales poses considerable problems in the present legal situation, the delimitation between input tax deductible and non-deductible turnover would create similar conflict potential within the area of tax exemption.

Section 4.2.4.: Option to tax for B2B supplies

The option to tax in the area of VAT-exempt service relations between companies for strictly professional purposes is an instrument that has been made available in a number of Member States since the introduction of the common value added tax system. It is also used by the credit services sector – albeit with differing intensity – in the area of tax-exempt financial services. While it does not necessarily present an ideal solution, it would nevertheless be useful to make the provision of the option by the Member States mandatory. Companies should in any case be free to decide whether or not to use option and should be able to apply it selectively to the turnover of individual operations.

Section 4.3.: Cross-border VAT bodies

VAT-bodies are of great importance for the financial sector, given the fact that credit institutions cannot recover VAT for an extensive number of VAT-exempt financial services, and that the VAT group option gives them a solution to avoid producing irrecoverable VAT at group level. With regard to VAT-bodies, we attract the Commission's attention to the need for action in two dimensions, the first dealing with the current treatment of VAT groups at Member States level, the other concerning the implementation of cross-border VAT groups:

1. **Member State level**: As stated in the introduction, VAT groups have been implemented to a very varying degree by the Member States. Thus some Member States have decided not to make the option available while others have restricted the scope, not allowing cooperatives to partake in such groups.

All Member States should be required to make the option for tax-grouping available to ensure that there is a level playing field between financial institutions coming from different jurisdictions.

Also, in the same spirit of fair competition, the implementation of VAT groups by the Member States should be company-form neutral, i.e. cooperative banks should be allowed to benefit from the possibility of forming tax groupings.

This is currently not possible in all Member States, e.g. in Germany, where this option is only available for companies linked by direct ownership and control (Organschaft). Since cooperative banks are grouped in networks, were banks own the central institutions of the group rather than the opposite, they do not come into consideration for VAT groups under this rather strict interpretation of the option.

2. **Cross-border VAT Groups**: In our view, the implementation of cross-border VAT groups, not possible under the current framework, would be of great interest for the financial sector. The need for the availability of such group structures has to be seen in the context of increasing globalisation and internationalisation of financial markets and the consolidation tendencies in the industry. In order to survive on a global scale, credit institutions will increasingly pursue economies of scale and synergies by way of creating cross-border entities at European level. These more efficient company structures should not be penalised by an additional VAT burden.

If the options above could not be pursued, we would suggest another approach, which could be the creation of a VAT banking group, which could be applicable to all company forms, cooperatives included.

Section 4.4.: Definition and valuation of tax-exempt services

This alternative represents the most promising way of adapting the VAT law contained in the 6th Directive to today's requirements. This has to be done with due regard for the principles of the legal precedents handed down by the European Court of Justice in relation to the definition of a financial service exempt from turnover tax. The general remarks made by the European Court of Justice regardless of the type of financial turnover in question have precedence over the definitions of the financial service or be enacted in a regulation (see "further points" below). This includes the following principles:

- The person of the provider and recipient of the service is insignificant for the existence of a financial service.

- The civil law relations between the provider and recipient of the service are insignificant for the existence of a financial service.

- To represent a tax-exempt financial service in case of outsourcing, the service must contain essential and specific elements of a financial service. A financial service can therefore be divided into several partial services. All partial services that are eventually part of a final service supplied to the customer should be exempted from VAT, even if these are provided by a third party.

The actual method of re-determining tax-exempt services should, in our estimation, be oriented to the fundamental purpose and the functions of a tax-exempt service and extensively circumscribe the financial services. The use of an economically oriented definition of the services is problematic in our view by virtue of the economic content of certain services changing over the years, while the purpose and function promise more a permanently applicable redefinition of a financial service. In the end, any service received by a bank which forms a necessary or indispensable part of an output financial service should be exempted.

It would, in our view, be an effective contribution towards simplifying the definition of financial services if these - as exceptions to the general tax obligation on services – were not, in turn, narrowed down by contra-exceptions. In our opinion, there are no understandable grounds for the contra-exceptions , e.g. in relation to the granting of loans concerning the administration of foreign loans and credit collateral, the exception in the case of business with securities with regard to the safe custody and administration of securities or in the collection of claims (factoring). The budget-related effects of a tax exemption for these services are likely, in our view, to be very limited based on the importance of these services in practical credit service business.

Further comments:

Amendment of the revision of the 6th Directive through a regulation

The 6th Directive contains the fundamental provisions of the value added tax system and establishes its structure. It gives the Member states a certain amount of leeway with regard to incorporation into national law, e.g. the exercising of options. With regard to its function, such a legal norm is not intended to formulate provisions in minute detail. We therefore feel that it would be a useful and effective addition to the revision of the directive if those provisions that do not appear suitable for inclusion in a directive were to be specified in a regulation. This has already been practised in the very recent past. Council Regulation (EC) no. 1777/2005 of 17 October 2005 (Official Journal L 288/1) sets out implementing provisions for the 6th Directive. The regulation instrument has the advantage of not having to be transferred into national law and bringing about a high degree of uniform legal application through direct applicability.