COUNCIL OF
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"I/A" ITEM NOTE

from:	General Secretariat
to:	Coreper/Council
Subject:	Proposals for a Council Directive and Regulation as regards the VAT treatment of insurance and financial services - Presidency progress report

1. On 14 December 2011 the Working Party on Tax Questions (Indirect Taxation) discussed the draft Presidency progress report on the Proposals for a Council Directive and a Regulation as regards the VAT treatment of insurance and financial services (doc. 17901/11 FISC 155) and agreed the text of the Report as set out in the Annex to this note.

2. The Permanent Representatives Committee is therefore invited to suggest that the Council take note of the Report (Annex) as an "A" item on its agenda.

PRESIDENCY PROGRESS REPORT

ON THE PROPOSALS FOR A COUNCIL DIRECTIVE AND REGULATION

AS REGARDS THE VAT TREATMENT OF INSURANCE AND FINANCIAL SERVICES

A. BACKGROUND

1. The provisions governing VAT treatment of insurance and financial services have not been changed for more than 30 years. Their interpretation and application by the Member States are however far from uniform. Furthermore, in the light of dynamic development of the EU insurance and financial services market and new complex products being offered in the market, it is also necessary to adjust the definitions to reflect better the current conditions of the pan-EU market. Therefore, the European Commission submitted to the Council in 2007 a proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the VAT treatment of insurance and financial services. The aim of the proposal was:

- clarification and updating definitions of the exempt insurance and financial services in order to ensure consistent interpretation throughout the European Union,

- broadening of the existing option for taxation by transferring the right to opt from the Member States to the financial and insurance institutions,

- introduction of a cost sharing group which allows financial and insurance institutions to cooperate without incurring additional non-recoverable VAT.

The abovementioned proposal is accompanied by a proposal for a Regulation, in which the Commission enumerated in a non-exhaustive way the examples of insurance and financial services covered by or excluded from the VAT exemption in respect of definitions of insurance and financial services provided for in the Directive.

2. At its meeting on 17 November 2010 during the Belgian Presidency, the ECOFIN Council took note of the situation and endorsed guidelines for future work (docs 15578/10 and 16455/10). According to the guidelines in question further work should be continued both with due consideration being given to ensure a level playing field between operators and between Member States, to strengthen the overall competitiveness of the financial and insurance sector of the European Union and to the budgetary implications. Furthermore the Council considered that there is no need for further work on cost sharing arrangements at the Council level. As regards option to tax, the Council invited the Commission to explore possible solutions allowing to depart from the existing VAT exemption. Further work on the definitions of exempt financial and insurance services should be pursued as a priority.

3. During more than 3-years of work in the Council's Working Party on Tax Questions, the proposals have been discussed extensively under the Slovenian, French, Czech, Swedish, Spanish, Belgian and Hungarian Presidencies, and visible progress was made.

4. According to the Hungarian Presidency's progress report (doc. 11092/11), of which the ECOFIN Council took note on 20 June 2011 (doc. 11271/11), further work on the taxation of the financial sector requires a careful balancing of several aspects which affect the Member States' perception of these issues, i.e. level playing field, competitiveness of the sector, budgetary implications; the future agreement should also take into account the ongoing work on identifying the tax base for financial services; and the evolution of the VAT Strategy and the initiatives on the taxation of the financial sector should also be acknowledged.

B. STATE OF PLAY OF THE DISCUSSIONS UNDER THE POLISH PRESIDENCY

5. The Polish Presidency has been continuing work on the two proposals in the Council's Working Party on Tax Questions – Indirect Taxation (VAT), focusing on the definitions of exempt financial and insurance services and taking into consideration guidelines of the Council of 17 November 2010, i.e. necessity of ensuring a level playing field between operators and between Member States, strengthening the overall competitiveness of the financial and insurance sector of the European Union and budgetary implications. To achieve those goals two sets of compromise texts were prepared, which have been discussed in detail during the meetings of the Working Party on Tax Questions – Indirect Taxation (VAT). Moreover and taking into account the Hungarian Presidency progress report, which identified four outstanding issues of political importance (transfer of insurance and reinsurance contract portfolios, outsourcing, management of investment funds and derivatives), in order to give impetus for further work the High Level Working Party (HLWP) discussed these issues on 26 October 2011.

C. RESULTS OF THE DISCUSSION IN THE HLWP ON 26 OCTOBER 2011

6. For the meeting of the HLWP on 26 October 2011 the Polish Presidency identified two possible solutions (doc. 15265/11):

    1) to continue the work on the basis of the package of guidelines (as set out in doc. 15265/11 FISC 127 of 7 October 2011 presented for the HLWP on 26 October 2011) that would form a future compromise; or

    2) to postpone further work on the dossier until examination of the VAT strategy and proposals on the financial sector taxation, which may lead to a new impulse in this file.

7. During the discussion in the HLWP the vast majority of Member States supported continuation of the work and have shown openness towards the efforts to achieve a compromise as soon as possible.

8. The Presidency took note of the constructive approach by the majority of delegations towards a guideline concerning a transfer of insurance and reinsurance contract portfolios, assuming that transfer of insurance and reinsurance contract portfolios and transfer of credit contract portfolios should be treated equally for VAT purposes, which would mean that both cases should be exempt from VAT. In the Presidency's view visible progress has been achieved in the work on outsourcing, where the majority of delegations supported narrow scope of definition, accepting that exemption within outsourcing should be granted only for services of financial or insurance nature. However, a few delegations supported broader application of exemption for outsourced financial and insurance services to avoid distortions of competition of the sector.

   Progress has also been made as regards the work on definition of management of investment and pension funds – the majority of Member States supported equal treatment of investment and pension funds, by application of exemption to management of funds, irrespective of their legal form and business structure, in order to avoid possible distortions of competition and not to create artificial burdens in the area of the management of those funds. However, a few Member States argued that certain types of pension funds were by their nature different from investment funds and, in their view, should not be exempt. Further discussions are needed in this respect and the Commission's services are currently preparing a room document on all of these issues which will be available in 2012. Some Member States again are of the opinion that the exemption should be limited to investment funds collecting savings of small investors. During the Polish Presidency work has been carried out in relation to transactions in financial derivatives. In the opinion of the majority of Member States exemption should apply to those of a financial nature, while transactions in commodities should be recognized as taxable. Nevertheless, further work should be undertaken to investigate the tax treatment of derivatives and, in this context, the merits of the simplification for exchange traded commodities.

9. The relationship with the VAT strategy and proposals on the financial sector taxation was discussed. Given that the proposal on FTT was of a different nature and that the new VAT Strategy was still under preparation in the Commission, the Presidency – bearing in mind the opinion of the Commission – noted, without prejudice to the future discussions, that at this stage it was difficult to assess what impetus from these two files could be expected for further work on VAT treatment of insurance and financial services. This approach also received support during discussion at the HLWP, where the vast majority of Member States was in favour of continuation of the work on financial and insurance services without waiting for the results of the work on FTT and VAT strategy.

10. In the light of the constructive discussion at the HLWP, the Presidency remains convinced that the work aiming at reaching a compromise in this dossier should be continued.

11. The Council is invited to take note of the progress achieved so far.