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**Implications of the CJEU judgments on cost-sharing
for the financial and insurance sectors**

1. INTRODUCTION

Questions concerning the interpretation and application of VAT rules can, on occasion, have wider implications in the face of the replies given. This is the case concerning the cost-sharing exemption provided for under Article 132(1)(f) of the VAT Directive¹ and its possible application to the financial and insurance sectors, as recently interpreted by the Court of Justice of the European Union (CJEU).

While the cost-sharing exemption is not exclusive to financial and insurance operators, it is an instrument largely used in these sectors. Financial and insurance services are usually exempted from VAT and, therefore, financial and insurance operators cannot deduct the VAT paid on their inputs – which therefore becomes a cost for them. Cost-sharing groups were traditionally used as a way to partly alleviate such VAT cost, but they are no longer available for financial and insurance operators according to some recent judgments of the CJEU².

Hence, it is necessary to examine the implications of such case-law for the financial and insurance sectors. In doing so, the broader context of the specific VAT rules that apply to financial and insurance services must be taken into account. The following sections aim at providing some elements of analysis to be taken into account as regards both the cost-sharing exemption and the VAT rules governing financial and insurance services.

2. THE COST-SHARING EXEMPTION

2.1. Relevant EU legislation

Article 132(1)(f) of the VAT Directive provides an exemption for cost-sharing arrangements, whereby Member States shall exempt:

"... (f) the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition".

The purpose of this exemption is to allow economic operators through the use of a cost-sharing group to pool the acquisition of services and re-distribute the costs for these services exempt from VAT, from the group to its members. In order for the exemption to apply, Article 132(1)(f) of the VAT Directive lays down five conditions to be met:

- 1) there must be an entity (usually referred to as "cost-sharing group") supplying services to persons who are members of that entity;

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

² CJEU, judgment of 4 May 2017, *Commission v Luxembourg*, C-274/15, EU:C:2017:333; CJEU, judgment of 21 September 2017, *DNB Banka*, C-326/15, EU:C:2017:719; CJEU, judgment of 21 September 2017, *Aviva*, C-605/15, EU:C:2017:718; and CJEU, judgment of 21 September 2017, C-616/15, *Commission v Germany*, EU:C:2017:721.

- 2) the members must be either taxable persons carrying on a downstream activity which is exempt from VAT or out of scope or non-taxable persons;
- 3) the services supplied by the group must be "directly necessary" for the exercise of the members' exempt or non-taxable downstream activities;
- 4) the services supplied by the independent group must be rewarded at cost ("exact reimbursement") and so the group must not make a profit out of the exempt services supplied to its members; and
- 5) the exemption from VAT of the supplies must not be likely to cause distortion of competition.

Given the divergence of views among Member States as to the interpretation and application of the cost-sharing exemption, this provision has on several occasions been subject of discussion by the VAT Committee: during the 74th (June 2004), the 91st (May 2010), the 104th (June 2015), and the 105th (October 2015) meetings. In this respect, Working papers³ have been produced by the Commission services but this has not yet resulted in any guidelines.

None of these discussions were focused on the application of the exemption to the financial and insurance sectors specifically (or on examining whether application of the exemption by these sectors was possible) but on other aspects which seemed more problematic (e.g. its cross-border application, and the interpretation of the condition concerning distortion of competition).

2.2. Recent case-law of the CJEU

Several cases concerning the interpretation of cost-sharing arrangements were recently brought before the CJEU: *Commission v Luxembourg*, *DNB Banka*, *Aviva*, and *Commission v Germany*. In three of those cases – *DNB Banka*, *Aviva* and *Commission v Germany* – the CJEU examined the availability of Article 132(1)(f) of the VAT Directive to the financial and insurance sectors, among other issues.

The CJEU found that in such cases cost-sharing arrangements are not applicable to the financial and insurance sectors, something which seems to depart from the current interpretation and application of this provision by most Member States⁴. In particular, the reasoning of the CJEU is based on the notion that cost-sharing groups are restricted to the category of operators engaged in activities in the public interest, given that Article 132(1)(f) of the VAT Directive is inserted in Chapter 2 of Title IX of the VAT Directive ("*Exemptions for certain activities in the public interest*"). In the opinion of the CJEU, financial and insurance activities do not fall within that category, notably because they are exempted based on rules laid down in Chapter 3 of Title IX of the VAT Directive ("*Exemptions for other activities*").

The CJEU followed the opinion of Advocate General Kokott (*DNB Banka*⁵ and *Aviva*⁶), but disagreed on this point with Advocate General Wathelet (*Commission v Germany*⁷), who was

³ Working papers Nos 450, 654, 856, and 883.

⁴ The CJEU itself acknowledged that some Member States exempt services supplied by cost-sharing groups to entities such as insurance companies, for instance, in paragraph 34 of *Aviva*.

⁵ Opinion of Advocate General Kokott of 1 March 2017, *DBN Banka*, C-326/15, EU:C:2017:145.

⁶ Opinion of Advocate General Kokott of 1 March 2017, *Aviva*, C-605/15, EU:C:2017:150.

of the opinion that the exemption should not be restricted to transactions of cost-sharing groups active in areas in the public interest.

3. THE VAT RULES GOVERNING FINANCIAL AND INSURANCE SERVICES

Again, it must be recalled that, by its wording, the use of cost-sharing groups has never been restricted to the financial and insurance sectors. Article 132(1)(f) of the VAT Directive simply requires, among the conditions outlined in section 2.1, that the members of such cost-sharing groups must be either taxable persons carrying on a downstream activity which is exempt from VAT or out of scope or non-taxable persons. Moreover, cost-sharing groups being available for the financial and insurance sectors seemed in line with previous case-law of the CJEU and notably its judgment in *Taksatorringen*⁸, which concerned the use of the cost-sharing exemption by insurance companies.

The only reason why cost-sharing groups are relevant for financial and insurance operators is because they are instruments used in order to alleviate much of the VAT cost derived from the fact that such operators cannot deduct the VAT paid on their inputs, as a result of their output supplies being exempt. Cost-sharing arrangements allow persons to create an entity from which they receive exempt input supplies (with VAT then being stuck with that entity).

3.1. Relevant EU legislation

Most financial and insurance services are exempted from VAT in accordance with Article 135(1)(a)-(g) of the VAT Directive, given that when EU VAT legislation was first put in place in 1977, it was found too difficult to apply VAT to them. As a consequence of the exemption in place, taxable persons supplying such financial and insurance services cannot deduct their input VAT, which therefore becomes a cost for them. An option to tax already exists in Article 137(1)(a) of the VAT Directive but it is used at the discretion of Member States. To the knowledge of the Commission, this option is currently used in a very limited way by a very limited number of Member States.

Irrecoverable VAT for financial and insurance operators at EU level was estimated for the year 2007 at EUR 33 billion⁹. However, there remains a good deal of uncertainty over whether the VAT exemption implies a tax advantage or disadvantage for the financial and insurance sectors (i.e. whether it leads to a lower or a higher level of revenues as compared to a full taxation regime).

It is difficult to find the precise reasons behind the VAT exemption in the law. Various explanations are possible, including economic and policy considerations, as well as the practical and administrative complexity of taxing financial services. It seems that one of the main reasons for financial services to be exempted is that it can be difficult to determine the tax base for certain services (e.g. intermediation services, financed out of the difference

⁷ Opinion of Advocate General Wathelet of 5 April 2017, *Commission v Germany*, C-616/15, EU:C:2017:272.

⁸ CJEU, judgment of 20 November 2003, *Taksatorringen*, C-8/01, EU:C:2003:621. While the CJEU did not specifically examine in *Taksatorringen* case whether the exemption in Article 132(1)(f) of the VAT Directive was to be limited to the services provided by a cost-sharing group whose members carried on activities in the public interest (this observation was made by the CJEU in *Aviva*, paragraph 33), the fact that the activities of the cost-sharing group in that case were insurance companies was not pointed out as an obstacle for the application of the exemption.

⁹ PWC, *How the EU VAT exemptions impact the banking sector*, 2011, p. 69.

between lending and borrowing rates). The exemption, however, reflects the way that Member States treated financial services prior to the Sixth VAT Directive¹⁰.

It should be noted that the CJEU has repeatedly stressed that the exemptions laid down in Article 135 of the VAT Directive are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person¹¹.

3.2. Previous attempts to review the current rules

Current VAT rules on financial and insurance services are believed to be complex and difficult to apply in practice, notably given that they have not kept pace with the developments of new services in the financial industry. This has led to increasing litigation before the CJEU, legal uncertainty, and high administrative and regulatory costs. Moreover, such rules are interpreted and applied inconsistently by Member States, which has resulted in tax competition and distortion within the EU.

In order to address such concerns, the Commission proposed in 2007 new legislation as regards the VAT treatment of insurance and financial services, which comprised a proposal for a Council Directive and a proposal for a Council Implementing Regulation¹². The proposals mainly aimed at clarifying and modernising the scope of the exemption, but they were not focused on more fundamental issues (that is, the fact that supplies of financial operators are exempt and, as a result, input VAT constitutes a cost for them). In particular, the proposals were based on the following three pillars:

- 1) clarification of the rules governing the exemptions;
- 2) broadening the existing option for taxation (right to opt for taxation transferred from Member States to economic operators); and
- 3) introduction of a cost-sharing group targeting financial entities.

Elements 2 and 3 of the proposals were left aside in Council, and discussions mainly focused on element 1.

The 2007 VAT proposals on financial services were withdrawn in 2016¹³. The discussion of the proposals had come to a standstill in Council, where it was last discussed under the Polish Presidency in 2011, mainly due to the inability of Member States to reach an agreement on several politically sensitive issues (notably, as regards the application of the VAT exemption for the management of investment funds and pension funds; and also transactions concerning commodity derivatives and outsourced services).

¹⁰ See Article 13B(a) and (d) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment (OJ L 145, 13.6.1977, p. 1–40).

¹¹ CJEU, judgment of 19 July 2012, *Deutsche Bank*, C-44/11, EU:C:2012:484, paragraph 42 and the case-law cited.

¹² Proposal 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 ([COM\(2007\) 747](#)); and Proposal 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 ([COM\(2007\) 746](#)).

¹³ OJ C 155, 30.4.2016, p. 3.

3.3. State of play

After the withdrawal of the 2007 VAT proposals, no further attempts have been made to review the current rules. While an evaluation of the present legislation should be carried out in order to identify and quantify possible problems derived from its interpretation and application at this moment in time, it seems that the issues which were already identified in 2007 remain and may have actually worsened due to several reasons, as indicated below.

Mainly, because in accordance with the judgments of the CJEU and as explained in section 2.2, cost-sharing groups are no longer available for the financial and insurance sectors as a way to alleviate much of their VAT cost.

But also because the current legislation does not seem to be fit for purpose in view of the financial and insurance business models which have evolved over the years.

In this respect, for instance, there is a high level of uncertainty as regards the VAT treatment of new forms of financial and insurance transactions, usually carried out electronically, which do not easily fit into the existing definitions for the exemption as laid down in the VAT Directive (e.g. crowdfunding, use of cryptocurrencies such as "Bitcoin", or peer-to-peer money transfers made outside the banking system such as "Transferwise").

Moreover, it is more common for financial and insurance institutions to outsource their inputs (as opposed to them being produced in-house), which has a negative impact on their VAT costs.

4. POLICY OPTIONS

In view of the recent developments as regards cost-sharing and the potential impact on the financial and insurance sectors, it seems that the current state of affairs is not sustainable. Therefore, several policy options could be considered at EU level. In this respect, the Commission services have been approached by numerous stakeholders from the financial and insurance sectors which have expressed their concerns as regards the outcome of the judgments of the CJEU and have urged the Commission to take action.

The policy options which could be envisaged are:

- 1) do nothing; or
- 2) prepare guidelines (soft-law); or
- 3) a legislative proposal with a narrow approach (making cost-sharing available for the financial and insurance sectors); or
- 4) a legislative proposal with a broad approach (review of the VAT rules governing the financial and insurance sectors).

See below a table with a non-exhaustive outline of advantages and disadvantages of each policy option, in the opinion of the Commission services.

	What to do?	Advantages	Disadvantages
1	Do nothing		<ul style="list-style-type: none"> Existing problems remain and are likely to worsen without EU action. It has been suggested using VAT groups as an equivalent to cost-sharing, but in the opinion of the Commission services it is difficult to see how VAT groups could accomplish the task to effectively alleviate the VAT cost borne by financial and insurance operators¹⁴.
2	Guidelines (e.g. VAT Committee guidelines)		<ul style="list-style-type: none"> There seems to be little margin for manoeuvre for interpreting the judgments of the CJEU on cost-sharing. Guidelines on the application of such judgments will not change the fact that cost-sharing groups are not available for the financial and insurance sectors.
3	Legislative proposal with narrow approach (making cost-sharing available for financial and insurance companies)	<ul style="list-style-type: none"> Political momentum after the judgments of the CJEU. Solution possibly available in the short-term which would allow restoring the <i>status quo</i> before the judgments of the CJEU (in most Member States). 	<ul style="list-style-type: none"> It deals with the symptom of the problem (alleviate the VAT cost), rather than the cause (the VAT cost stems from the current exemption of financial and insurance services). If this option is chosen, this will hamper any deeper review of the VAT rules governing the financial and insurance sectors in the future.
4	Legislative proposal with wide approach (review of the VAT rules for financial and insurance services)	<ul style="list-style-type: none"> Political momentum after the judgments of the CJEU. Experience gained from the discussions on the 2007 proposals could be built on. Solution which would allow evaluating the current rules and 	<ul style="list-style-type: none"> Solution available in the middle or long-term.

¹⁴ VAT groups are laid down in Article 11 of the VAT Directive, and they allow several closely bound persons to form a single taxable person for VAT purposes (supplies between such entities are out of the scope of VAT). There are several reasons why VAT groups do not seem to be an equivalent to cost-sharing groups: (i) VAT groups are optional for Member States to apply (the relief measure is not generally available within the EU, although it can be used by financial and insurance economic operators once implemented by a Member State); (ii) they are only available for entities with close financial, economic and organisational links (very narrow application); and (iii) they can only be used by persons within the same Member State. The latter condition hampers in particular the use of VAT groups by multinational enterprises (MNEs), because only the entities of the MNE physically present in the Member State where a VAT group is formed could be part of that VAT group (and links with entities abroad are cut off for VAT purposes).

		exploring several policy options accordingly ¹⁵ . Such a review could assess the suitability of a policy option targeting the cause (exemption) rather than the symptom (need to alleviate VAT cost).	
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5. QUESTIONS TO THE MEMBERS

Members are invited to:

1. express their views as to the impact of the judgments of the CJEU on cost-sharing for the financial and insurance sectors.
2. comment on the need to act at EU level and, if so, state which policy option is preferred.

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¹⁵ Those policy options could include making cost-sharing available for financial and insurance companies, and also build on the good progress made on some points of the 2007 proposals (for instance, on the definition of the exemptions). Other policy options could examine the appropriateness of maintaining the VAT exemption altogether which, in the end, is the reason why cost-sharing groups are used by financial and insurance operators.