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# *Financial Services VAT Alert*

## Tracking EU VAT Developments

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## Editorial

Welcome to the June edition of the FS VAT Alert!

In this edition you will see that there is a lot happening at EU level. We will update you on the progress made by the Hungarian Presidency on the proposals for the FS Directive and Regulation as well as the entry into force of the implementing regulation as from 1st July 2011. Also, you will find some interesting information on the financial transaction tax that should be introduced in 2018. Denmark provides an update on the VAT treatment of the on-charge of fuel costs and insurance costs by leasing companies. For Germany, we have updates related to investment funds which could also affect other players in the financial sector. These items deal more precisely with the VAT treatment of intermediary services when using sub-agents and a question referred to the ECJ on the VAT treatment of investment advice. You will also learn that in Germany the sale of even 99% of share capital is not treated as a transfer of a going concern. Italy informs you on the hearing of the ECJ regarding the time limits for reimbursement of VAT paid by mistake and the Commission's opinion in this regard.

Enjoy reading!

*Chantal Braquet (Editor)*

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## EUROPEAN UNION

### 1. FS Proposal Directive & Regulation – progress report

At its meeting on 21 June 2011, the Council took note of the progress made and the problems still to be resolved regarding the Commission's proposals to modernise the VAT treatment of financial and insurance services.

The proposals for a directive and regulation presented on this subject in 2007 aim to update the definition of services exempted from VAT and include a mechanism to establish cross-border cost-sharing groups, and extend the option for service providers to apply normal VAT rules.

Progress has been made and tentative agreement was reached on a number of issues like e.g. the definition of insurance and re-insurance transactions, while the discussions on the positive and negative examples in the draft regulation regarding e.g. financial transfer, account operation, etc. are drawing to a close.

The Hungarian Presidency noted mainly four outstanding points at this stage:

- 1) the transfer of insurance and reinsurance contract portfolios;
- 2) outsourcing;
- 3) investment fund management; and
- 4) derivatives.

Although Member States interpret the current rules differently, the Hungarian Presidency is of the opinion, that there is a common understanding amongst the Member States that a level playing field should be achieved through the

modernisation of the definitions. Harmonised rules would require a careful balancing of several aspects of a complex situation (level playing field, competitiveness of the sector, budgetary implications), as these cannot always be achieved without some trade off.

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### 2. Recast implementing regulation takes effect on 1 July 2011

The recast implementing regulation laying down rules for the implementation of the EU's Principal VAT Directive (Directive 2006/112/EC) will have effect from 1 July 2011. The aim of the regulation is to ensure better compliance with the objectives of the EU internal market. Being a regulation, it will be directly applicable in all 27 EU Member States. This means it will have legal effect without the need for it to be implemented into national legislation, potentially 'trumping' those countries where some or all of the relevant provisions have not, until now, been implemented.

The implementing regulation covers amongst others the following items:

- how to determine the place where a business is established;
- the definition of a "fixed establishment";
- how to determine to, or from, which place of establishment, a service is provided;
- when a fixed establishment is considered to "intervene" in a supply;

- what can be considered as sufficient checks regarding the taxable status of customers;
- European Economic Interest Groupings (EEIG);
- the taxable amount - credit card charges;

All businesses trading in the EU will need to make themselves familiar with the provisions contained in this regulation in order to ensure continuing compliance and competitiveness.

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### **3. Commission proposes two new 'own resources' - a financial transaction tax and a modernised VAT**

On 29 June, the European Commission, proposed the multi-annual budget for 2014 - 2020. In it, the Commission is proposing abolition of the current VAT-based own resource (a proportion of the national VAT collected by Member States) as of 2014 and replacing this with the introduction of two new own resources as part of the next EU budget - a financial transaction tax (FTT) and a "new modernised VAT".

This announcement follows on the heels of the Commission's public consultations on 'The future of VAT - Towards a simpler, more robust and efficient VAT system' in December 2010 and on financial sector taxation in March 2011.

The new own resources will be as follows.

- 1) A new FTT to be introduced from 1 January 2018 at the latest, with the maximum tax rate to be set at the moment of legislative proposal.

- 2) Also from 1 January 2018, a share of the VAT on supplies of goods and services, intra-Community acquisitions of goods and importation of goods subject to a standard rate of VAT in every Member State, with the rate applicable not exceeding two percentage points of the standard rate.

The Commission states that:

"The development of a new VAT resource would bring a new impetus to the development of the Internal market by reinforcing harmonization of national VAT systems. The new VAT resource would be one facet of a markedly revised VAT system in the EU in the wake of the Green Paper on the future of VAT. The new initiative will include the elimination of a number of exemptions or exceptions which are detrimental to the proper functioning of the Internal market and the measures to reduce VAT fraud in the EU."

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## **DENMARK**

### **4. Decision from the National Tax Tribunal on input VAT recovery regarding the on-charge of fuel costs**

A German bus leasing company with a Danish VAT registration number could not recover Danish VAT on the purchase of fuel in Denmark that was included in the leasing payment from the Danish lessees to the German lessor. The leasing payment was subject to German VAT as the leasing took place before 1 January 2010.

In accordance with the principle in the ECJ Case Auto Lease Holland the supply of fuel took place from the gas station directly to the Danish lessee. Therefore the leasing company did not resell the fuel but provided financing facilities, exempt from VAT. Consequently, as VAT on costs relating to VAT exempt activities are not recoverable, the Tax Authorities argued successfully before the Tribunal that input VAT regarding the purchase of fuel is not recoverable for the leasing company.

This can have an effect on lessees of yellow plate cars (vans) as this means that the VAT on the leasing payment related to the fuel is non-recoverable. Please note that there is no VAT recovery on leasing of passenger cars (white plate cars).

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#### **5. Binding ruling from the National Tax Board: Recharge of insurance fees by leasing companies regarded as a separate VAT exempt insurance supply**

Insurance fees recharged by a leasing company are treated as a separate supply, which is exempt from VAT. As the leasing company provides both VAT taxable and VAT exempt services, it has to compute a VAT recovery ratio to determine the amount of recoverable input VAT. Another possibility for VAT recovery would be the real use method, which could potentially lead to a higher recovery of input VAT. Input VAT incurred on the purchase of the cars will still be fully recoverable.

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## **GERMANY**

### **6. Lower Tax Court of Rhineland-Palatinate denies VAT exemption for investment-fund-related intermediary services where the claimant uses sub-agents**

*Pending appeal on fund distribution companies and other financial intermediaries using sub-agents*

The claimant distributes parts issued by foreign investment companies and engages sub-agents for direct customer contact. The claimant supports the sub-agents with fund-related trainings, produces information materials and information events.

Moreover, according to its legal and contractual obligations the claimant reviews all purchase orders regarding plausibility, completeness and signature. Incorrectly filed orders are rejected.

According to the Lower Tax Court, the services rendered by the claimant appear as general distribution and administration services subject to VAT, in other words, no VAT exempt financial intermediary services are rendered. Those services may only be VAT exempt if the claimant acted as a (main) intermediary.

For the Court, the claimant does not act as an intermediary because it merely supports the sub-agents and does not have the power to influence the conclusion and content of

purchase contracts relating to the investment funds. According to the Court, acting as an intermediary requires more than just back-office and administration activities.

The Court's judgment seems highly debatable as the VAT exemption for services rendered by a main intermediary should generally not be challenged on the ground that such intermediary outsources part of these services or even the complete intermediary service to sub-agents. The right to lodge an appeal before the Supreme Tax Court has been granted and exercised.

Taxpayers who may be affected by this decision should contact their usual PwC VAT advisor or Christian Schubert in order to check whether a suspension of proceedings may be advisable considering the pending final decision.

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## **7. German Supreme Tax Court refers question to the Court of Justice of the European Union (“ECJ”) regarding the VAT exemption of financial advisory services rendered to investment companies**

### *Extensive effects for investment companies and their advisors may be expected*

The claimant rendered investment advisory services to investment companies regarding investment decisions for an investment fund. In most cases, the recommendations were followed by the investment company provided applicable legal formal requirements were met. Whereas formally the final investment decision remained with the investment company, in practice, the claimant took the investment decisions concerning the fund.

The Lower Tax Court rejected the application of the VAT exemption for the management of investment funds, and held that those services qualify as mere advisory services (please see our FS VAT Alert March 2011).

Following the claimant's appeal, the German Supreme Tax Court (“GSTC”) has decided to suspend the proceedings and to refer preliminary questions to the ECJ.

The GSTC specifically raised questions regarding the requirements applicable for the VAT exemption of outsourced fund management services as stipulated in the Abbey National case. According to this decision, the services supplied must concern specific essential elements of the management of investment funds and form a distinct whole in order to be VAT exempt.

The GSTC doubts that the advisory services at hand are "specific" within the meaning of the ECJ case law as, legally, the final investment decision remains with the investment company. In case these services should be seen as being adequately "specific", the GSTC wonders whether advisory services in relation to investment funds must have specific features in order to distinguish them from other advisory services being subject to VAT (e.g. investment advice for private investors concerning direct investments in securities). Moreover the GSTC wants to know, whether the VAT exemption may depend on the admissibility for outsourcing according to other legislation.

Where VAT has been assessed in relation to investment advisory services as described above, taxpayers should file an objection against this VAT assessment and apply for a suspension of the proceeding until the ECJ has decided upon this case.

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## **8. Sale of 99% shareholding is not a transfer of a going concern**

The German Supreme Tax Court has held that the sale of less than 100% of the share capital of a subsidiary cannot be considered a sale of a business. The transaction is a VAT exempt sale of shares and the input VAT on the associated costs is not deductible.

A company wished to sell a subsidiary in order to gain cash for reinvestment in its core business. It sold its holding to a US

company under an agreement allowing that company to appoint the exact (related-party) buyer at a later stage. However, the company could sell only 99% of the shares as the other 1% was held by a third party with no direct involvement in the transaction. In the course of the sale, the company took structuring advice from a lawyer and financial advice from a banker. Both consultants charged VAT on their bills and the tax office refused an input tax deduction in both cases.

While the company appealed successfully to the lower tax court, the Supreme Tax Court judged that the legal and financial consultancy charges were incurred in connection with a tax-free sale of shares. The related input VAT was therefore not deductible. The sale of a 99% holding could not be equated with the non-taxable sale of a business (assets sale) as the sale of a business implies the full transfer of ownership rights. Thus, only a full transfer of all the shares could achieve equal status.

In theory, it would be possible to treat the transfer of the shares held in an Organschaft subsidiary as the sale of a business under certain conditions, which were not met in the case at hand. As a last resort, the company tried to argue that its reason for the sale was to gain cash to fund the expansion of taxable activities. The Supreme Court decided that the purpose as stated only led to an indirect connection with the expenses at issue. The direct connection was to the tax-free share transfer. This remained the determining factor for the denial of input tax deduction.

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## ITALY

### **9. Hearing of the ECJ - Reimbursement and time limits where VAT has been paid by mistake (c-427/10 Banca Antoniana Popolare Veneta S.p.A. “BAPV” v Italian Ministry of Finance)**

*The EU Commission has recently issued its reply regarding the question, referred to the ECJ, in relation to the reimbursement and time limits for VAT wrongly paid (different timing in case of ordinary law versus tax law)*

The question referred relates to the interpretation of the principles of effectiveness, non-discrimination and tax neutrality in a case where:

- due to the change in the VAT treatment based on different guidance issued by the Italian Tax Authorities, VAT previously paid mistakenly by the customer to BAPV was asked to be refunded by and obtained from BAPV – under civil law the time limit to ask the supplier for reimbursement of any undue payments was (still is) 10 years;
- the refund of such VAT paid by mistake by BAPV to the Italian Tax Authorities was however denied by the latter because the time limit provided by the tax law was (still is) 2 years from the payment to the Tax Authorities.

According to the Commission, the principles of effectiveness, equality and the prevention of unjust enrichment preclude a discipline or practice whereby, due to a different limitation period for lodging appeals according to a civil action compared to the limitation period to lodge a tax procedure, a taxpayer, who has paid VAT which is not due, suffers a financial loss, when other subjects, in particular the Treasury, are enriched without a cause. BAPV agrees with the Commission, while Germany and UK disagree.

It remains to be seen which position the ECJ will take as this could potentially open possibilities for Italian tax payers in similar situation as BAPV to recover VAT incorrectly paid.

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