



**COUNCIL OF
THE EUROPEAN UNION**

Brussels, 30 June 2009

**Interinstitutional File:
2007/0267 (CNS)**

11584/09

LIMITE

FISC 92

NOTE

from:	the forthcoming Swedish Presidency
to:	Working Party on Tax Questions - Indirect Taxation (VAT)
Subject:	Treatment of outsourcing services for VAT purposes in the financial and insurance sector

1. The purpose of this note is to have an exchange of views in the Tax Questions Group on a Presidency proposal for a legal text regarding the outsourcing rule in article 135 1a. in the COM proposal for a Directive (COM(2007) 747 final/2). The Presidency will invite delegations to express their views through a table-round.

During the CZ Presidency it was suggested that the issue should be dealt with in detail at a later stage, once the definitions and the examples of insurance and financial services, to which outsourcing relates, are agreed. However, the Swedish Presidency is of the view that the discussions in the Tax Questions Group have reached a stage when a principle standpoint may be taken regarding the scope of the exemption for outsourcing of activity.

2. The Presidency has the intention, on the basis of the outcome of the discussion on this paper and on the basis of the outcome of the earlier discussions during the CZ Presidency on the definitions of insurance and financial services, to base further discussions in the group on the two separate legislative acts, the proposal for a Directive and the proposal for a Regulation. These papers will be discussed in parallel in the Tax Questions Group in September.
3. The Tax Questions Group has on several occasions during the negotiations in Council discussed the provision regarding outsourcing in article 135 1a. The following dividing line in the group has been identified.

A number of delegations want to introduce in the legal text a criterion which says that the services provided must entail "changes in the legal and financial situation". This criterion is taken from the Sparekassernes Datacenter (SDC) ruling (C-2/95 of 5 June 1997).

Other delegations want the exemption to cover outsourced back office services in the insurance sector which currently are deemed taxable by the ECJ in the Arthur Andersen ruling (ruling C-472/03 of 3 March 2005). Therefore, they see a problem using this criterion in the legal text.

If the criteria saying that the service must entail "changes in the legal and financial situation" is introduced in the legal text, back office services in the insurance sector and credit management services carried out by someone else but the person providing the insurance or granting the credit, would most likely *not* qualify as exempt outsourcing services.

4. In the Commission proposal for a directive COM(2007) 747 final/2 the COM suggested the following wording:

"1a. The exemption provided for in points (a) to (e) of paragraph 1 shall apply to the supply of any constituent element of an insurance or financial service, which constitutes a distinct whole and has the specific and essential character of the exempt service."

(The text did not refer to intermediation services nor management of investment funds. The wording is influenced by the SDC ruling (C-2/95).

In the COM proposal for a regulation COM(2007) 746 final/2 the COM suggests in article 14 that claims handling has the "specific and essential character" of an insurance and reinsurance service, whereas "damage assessment" shall not, according to the proposal, be considered to be a service having the specific and essential character of insurance and reinsurance.

Furthermore, recital no 4 in the proposal for a regulation COM(2007) 746 final/2 says that in order to determine whether certain services are exempt which form a distinct whole and is a constituent element of an insurance or financial service, regard should be had to whether the services in question change the financial or legal situation of the parties to an exempt transaction or whether, by contrast they are mere material or technical supplies.

The negotiations in the working Tax Questions Group has shown that there are divergent interpretations of the proposed texts regarding what services would be covered by the exemption and what services by outsourcers would fall outside the exemption. The text proposed by the COM has undergone some changes during the negotiations and currently it looks like this (document 7889/09 FISC 36):

"1a. The exemption provided for in points (a) to (ge) of paragraph 1 shall apply to the supply of any constituent element of an insurance or financial service which itself forms a distinct whole and is specific to and essential for the exempt service."

(The text now includes specific reference to management of investment funds but not to intermediation services which are currently covered in article 135(1)(gf). The COM did in a room document for the meeting on 4 May 2009 elaborate on the distinction between intermediation services and constituent elements mentioned in article 135 1a.)

5. Member States and the Commission have agreed that the basis for the legislative process within the EU concerning the exemption for VAT on insurance and financial services is the current scope of the exemptions, taking into account the development in the ECJ in this area. For outsourcing there are several relevant rulings. Some of them are briefly summarized below. Member States have also said that the Directive shall set the legal framework for the exemptions and the examples of services in the Regulation must reflect that legal framework.

Brief summaries of some important rulings:

C-2/95, SDC: The exemption is not subject to the condition that the transactions are effected by a certain type of institution, by a certain type of legal person or wholly or partly by certain electronic means or manually.¹ Exempt transactions are defined according to their nature and not according to the person supplying or receiving them. In order to be characterized as exempt transactions the services must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of a service [described in points 3 and 5 of Article 13B(d) in the Sixth Directive]. For a transaction concerning transfers of money, and trade in securities, the services provided must involve changes in the legal and financial situation as between the parties. A service exempt under the Directive must be distinguished from a mere physical or technical supply, such as making a data-handling system available to a bank.

¹ The ruling dealt with points 3 and 5 of Article 13B(d) in the Sixth Directive.

C-472/03, Arthur Andersen: “Back office” activities in insurance such as acceptance of applications for insurance, the handling of amendments to contracts and premiums, the issuing, management and rescission of policies, the management of claims, the setting and paying of commission to insurance agents, the organisation of management of information technology etc., provided to an insurance company are not services relating to insurance transactions carried out by an insurance agent.

C-8/01, Taksatorringen: Damage assessment services carried out by an association whose members are insurance companies are neither insurance transactions nor services related to insurance transactions that are performed by insurance agents. The court found that an interpretation by analogy of the SDC ruling was not possible. The SDC ruling concerns transactions related to certain banking operations, while the exemption concerning insurance covers insurance transactions in the strict sense.

C- 169/04, Abbey National: Management of special investment funds covers the services performed by a third party manager in the respect of the administrative management of the funds if, viewed broadly, they form a distinct whole, and are specific to, and essential for, the management of those funds.

These rulings are interpreted in divergent ways throughout the EU. In some Member States they are interpreted in a strict way, whereas in other Member States the interpretation is more liberal. The aim is to attain a harmonised approach to the exemption for insurance and financial services in order to have a level playing field for business within the EU.

6. The Presidency has the following suggestion for the legal text in article 135 1a:

135 1a:

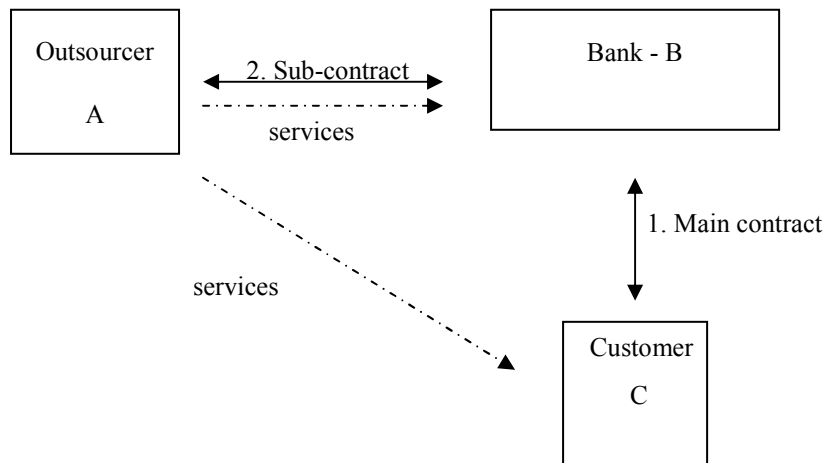
"The exemption provided for in points (a) to (g) of paragraph 1 shall apply to the supply of any constituent element of a financial service which itself constitutes a distinct whole and is specific to and essential for the exempt service. To be exempt under this point, the supply provided [by the sub-contractor must be intended to form part of the contractual obligations of the main supplier and] must entail a change in the legal and financial situation."

Comment:

According to settled case-law of the ECJ, the terms used to describe the exemptions envisaged by Articles 132-135 of the VAT Directive (formerly Article 13 of the Sixth VAT Directive) are to be interpreted strictly since these constitute exceptions to the general principle that turnover tax is to be levied on all services supplied for consideration by a taxable person (see ruling 348/87 Stichting Uitvoering Financiële Acties). The text above is built on the current case-law in the SDC-ruling (in particular points 53, 66 and 73 thereof) introducing the criterion which says that in order for the service to be exempt the service provided must entail "changes in the legal and financial situation". The criterion would apply to all the categories of insurance and financial services including management of investment funds and intermediary services.

In the SDC-ruling the Court provides the following example of the meaning of the particular criterion (p. 53); the execution of an order for the transfer of a sum of money from one bank account to another is characterized by the fact that it involves a change in the legal and financial situation existing between the person giving the order and the recipient and between those parties and their respective banks and in some cases, between the banks.

The text in brackets would underline that the exemption is aimed at outsourcing contracts between the main supplier (core provider) of the insurance or the financial service and the sub-contractor. However, the customer of the main supplier may in some cases be the actual recipient of the services provided by the sub-contractor.



The wording will exclude outsourcing of administrative or technical services such as handling of bank statements, opening accounts, handling of credit applications etc., which do not incur changes in the financial and legal situation between the parties. Where such services are provided by the main supplier (a bank for example) to its customer (no subcontractor is involved) the VAT-treatment of that service could be determined according to the principles set out in the CPP-ruling, C-349/96 points 30-32 for single or multiple supplies.

To summarise, the Presidency can see the following advantages and disadvantages with the suggested text:

Advantages

- The added words would provide objective criteria for the interpretation and they would restrict the scope of the exemption for outsourcing. They could improve legal certainty for the application of the rule.
- A strict wording would restrict the exemption for insurance and financial services. This is in line with the principles for strict interpretation of the exemptions set down by the ECJ. It is also important not to forget the reason behind the exemption for financial services being that these services can be technically difficult to tax (establishing the relevant taxable amount). This reason is less relevant for outsourced activities. Furthermore, it is difficult to justify a particular exemption for outsourcing in the financial sector, whereas in other areas of VAT exemption such as health care and education, outsourcing will not be exempt.
- Expanding the exemption up-stream only moves the general problems of the application of the exemption (problems defining the limits for the exemption, problems regarding right of deduction, etc.).

Disadvantages

- The text is setting strict limits to the exemption for outsourcing. It will mean that some Member States will have to restrict the exemption for insurance and financial services in their national law in some cases, depending on their current application of the existing law including case-law in this area.

- The text could lead to unequal treatment for VAT purposes of services provided in-house and services which are outsourced, for example management of claims in the insurance sector, although those services are of the same nature. This will depend on whether the service forms part of the main supply or is regarded as a separate supply (see the principles in the CPP-ruling, C-349/96).
- The text could prevent the insurance and financial sector to structure their activities in the most efficient way, for example concentrating a particular activity to one entity within a group for example which provides all other entities in that group with particular services, because it would entail VAT on those services.

All delegations are invited at a table round to present their views on the following:

1. Do you support the text proposed by the Presidency or do you prefer the text in FISC 36?
2. Do you think that the text in brackets is needed?
3. Any other remarks?
