PensionsEurope input to the European Commission consultation on VAT rules

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General remarks

PensionsEurope supports the European Commission's objective to simplify the life of taxpayers operating in the Single Market and we welcome the review of the VAT rules. In our joint position paper (November 2018) together with AEIP on the necessary steps to relieve pension fund participants from unnecessary VAT burden, we called for an amendment to the VAT Directive that provides more clarity with respect to the legal basis of the VAT exemption for pension funds and occupational pensions, is non-discriminative with regard to pension schemes, and is up-to-date.

In general, we believe all pension fund participants should be protected from unnecessary VAT burdens, regardless the character of the schemes (DB / DC / hybrid) as well as the Member State in which the services are being received. This exemption is especially relevant since pension plans (i) are in essence cost-sharing arrangements of beneficiaries with a clear public interest of preventing poverty among the elderly, as well as providing for survivor pensions, and (ii) they deliver services themselves that are being exempt meaning their VAT on purchases of services or goods cannot be recovered. Thus, **we speak out for the retention of relevant VAT exemptions and are clearly against a general abolition of the system of VAT exemptions or relevant VAT exemptions as we do not see the stated advantages in the Commission's Roadmap** ("*The removal of the exemption would not only free the suppliers of financial and insurance services from irrecoverable input VAT, but it would greatly simplify the VAT rules for the sector*"). If VAT exemptions for financial and insurance services would be abolished in a broad manner to create "VAT neutrality" this would at the end lead to an increase in cost and a reduction in benefits for beneficiaries because the cost decrease under way for purchased preliminary products and services will not outweigh the likely increase due to the abolition of VAT exemptions.

The current exemption, in the light of the case law, seems to work for pension funds in most countries. Nevertheless, there is some ambiguity as to the application of the VAT Directive to pension schemes. In the landmark Wheels and ATP cases, the ECJ has set out the conditions for the application of the exemption for special investment funds to pension schemes. The most crucial test is to assess whether the pension fund participants bear the investment risk. Whereas this differentiation is useful when distinguishing between 'pure' DC and DB schemes, there also exist many types of 'hybrid' schemes that combine elements of both systems. It is unclear how the case law relates to these hybrid schemes. The legal uncertainty and the mass of relevant case law thus arises most from the fact that pension schemes have to qualify under Art. 135 (1) g VAT Directive that emphasises certain characteristics from investment funds. **To reduce legal uncertainty and resulting complexity in arrangements a clear and undisputable legal exemption from VAT for management services and custody services to all types of pension schemes** (particularly Institutions for Occupational Retirement Provision (IORPs) as defined by the Art. 6 (number 1) of the Directive 2016/2341) is needed and would be much more effective than disrupting the system of relevant VAT exemptions in total. Furthermore, regarding the Article 135 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of VAT, we would like to suggest adding on the Paragraph 1 (letter f) the management and the safekeeping in shares, interests in companies or associations, debentures, and other securities, so as also the services provided by the custodian banks would be exempted from VAT.

We recommend providing certainty irrespective the Member States in which the management and custody services are rendered. Even though Member States have organised their pension system differently, economically these pension systems are comparable in essence. Regardless of the type of commitment, all pension plans should be treated the same for VAT purposes. Therefore, we believe **the current exemption for special investment funds should be extended to all pension schemes.**

The EC's combined evaluation roadmap/inception impact assessment states that *"Existing distortions linked to the exemption and its diversified application across the Member States should be reduced."* Even though the VAT exemption is in place, in some countries there is a stamp duty (for instance 4%) that is not subject or exempt from VAT and there is no possibility of any deduction. In other Member States the investments of pension funds in real estate are not exempted from VAT. We urge the EC to recommend Member States to exempt (at least) pension schemes from the stamp duty (or decrease their duty to no more than 1%) and to exempt all the investments of pension schemes, including those on real estate.

Finally, PensionsEurope believes that establishing a cross-border investment-friendly tax environment in the EU not only requires removing unfair tax treatment but also introducing tax incentives. The EC's statement that "[…] Tax and other financial incentives, as well as collective bargaining play an important role […]" in "improving the cost-effectiveness, safety and equitable access to supplementary pension schemes" is still valid and should be taken into account as well.[1] Regarding financial incentives, for instance OECD report on "Financial incentives for funded private pension plans in OECD countries" (November 2019) is very helpful. Recently also the High-level group of experts on pensions recommended in its final report (of December 2019) that "*Member States should reserve tax and/or financial incentives in both the saving and the pay-out phase for supplementary pensions meeting minimum quality requirements. These incentives should reflect the diversity in characteristics of types of pensions and the related social policy of a Member State*".

In our answers below, we have particularly focused on the questions which we have found the most relevant.

[1] EU White Paper 'An Agenda for Adequate, Safe and Sustainable Pensions' (COM(2012) 55 final).

Answers to specific questions

Question 20: *The exemption of financial and insurance services from VAT was introduced in 1977 as an exception to the general rule that VAT is to be levied on all services supplied for consideration by a taxable person. To what extent do you agree that the exemption is still needed?*

- Strongly agree
- **Agree X**
- Neutral
- Disagree
- Strongly disagree
- Not sure

PensionsEurope explanation:

The VAT exemption for financial services was also introduced, as the tax base is difficult to determine, and the services provided to end consumers should be as inexpensive as possible. As long as no other solutions have been developed for these objectives, the current taxation system should remain in place, but a modernization is urgently needed.

We strongly believe that the exemption is still needed because a repeal of the exemption risks to lead (yet again) to a cost increase for IORPs and their members, given the fact that the IORPs are unable to recover the VAT on purchases of services or goods. This rise of expenditures will either have to be financed by the sponsor or be borne by the members. Neither of these scenarios will lead to a positive outcome. Sponsors are already confronted with historically low interest rates and face very challenging times given the economic uncertainties in the wake of the Covid-19 crisis. Additional costs borne by members will lead to a decline in the adequacy of their pensions, this against a backdrop of (e.g.) the Capital Markets Union Action Plan where Member States are called upon to create a Pension dashboard to facilitate the monitoring of pension adequacy.

As per illustration we believe it to be expedient in this context to refer to the intentions the Belgian government laid out in its Coalition Agreement (30 September 2020) regarding the 2nd Pillar: "The costs (entry costs, management costs, ...) charged by pension institutions in the context of the 2nd and 3rd pillar will be inventoried, analyzed and, if necessary, measures will be taken.

Cost reduction is an important factor in improving the return on supplementary pensions. This can be done through administrative and legal simplification, among other things. That is why, together with all stakeholders, a comprehensive overview will be made of the further possibilities for automation and cost reduction in the administrative management and handling of supplementary pensions, the legal obstacles will be mapped out and a step-by-step plan will be drawn up for the realization of more efficient solutions."

We fully subscribe these goals as we believe that (new) regulations should be geared towards cost reduction and – efficiency, and efficient administrative solutions. We therefor do not concur with the statement mentioned in the survey that "the current rules are believed to be complex and difficult to apply in practice, and possibly have not kept pace with the developments of new services in the financial industry (for example services linked to crypto-assets and e-money). This seems to have 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 contributes to distortions within the EU and in exchanges with third countries." On the contrary, a (partial) repeal of the exemption would – at least for pension funds – lead to a situation of legal uncertainty and increasing costs. This is a strong argument in favor of extending the current exemption for special investment funds to all pension schemes, meaning that all pension plans should be treated equally for VAT purposes, irrespective of the Member States in which the management services are rendered.

Question 21: *In general, how would you assess the functioning of the exemption of financial and insurance services?*
The exemption...

- ... works very well
- **... works well, but could be improved X**
- ... works poorly and should be improved
- … should be removed

PensionsEurope explanation:

There is legal uncertainty regarding the VAT exemption of the administration of occupational pension schemes. For instance, according to the wording of the German VAT exemption provision, the management of pension institutions within the scope of application of the Insurance Supervision Act is exempt from VAT. However, it is disputed whether - beyond the wording of the national tax exemption provision - only those pension institutions are covered by the tax exemption that manage special investment funds in the sense of the VAT Directive. Legal certainty on this issue could be provided only if Art. 135 of the VAT Directive were amended to include a clear and unambiguous VAT exemption for the administration of all types of occupational pension schemes. The exemption of pension schemes should be irrelevant of the type of benefits that the pension schemes offer. The wording of such an exemption provision in Article 135 could read: „(1) Member States shall exempt the following transactions: (m) management services and custody services to pension schemes providing post-employment benefits such as retirement benefits and benefits in the event of death or incapacity for work."

A second example is the current case law in the Netherlands. In December 2016, the Hoge Raad has refused application of the VAT exemption to a pension fund based on conditions different from the conditions formulated by the CJEU (ECLI:NL:HR:2016:2786). The Dutch tax authorities are since following the conditions of the Hoge Raad since, thereby not giving full application to the conditions formulated by the CJEU. In paragraph 2.3.3. of its judgment, the Hoge Raad considers that the risk regarding the pension fund's investments is borne by its participants. As the other conditions were undisputedly met this consideration should have been sufficient to decide that all conditions as set out by the CJEU in ATP were fulfilled. Yet, the Hoge Raad concludes that the pension fund in question is not a SIF, whilst not fully applying the 'comparability test'[2].

Question 35: *Do the current VAT rules for financial and insurance services result in prices lower than those that would apply if these services were taxed?*

- Yes, but just for final non-taxable customers
- Yes, for all customers
- **In part, due to other similar taxes X**
- No
- Do not know

PensionsEurope explanation:

In general, the VAT exemption itself is helpful in reducing taxes on prices for insurance including pensions and financial services. However, the hidden VAT is passed on to the consumer increasing the price of the insurance cover. Furthermore, in many Member States other similar taxes are being levied on insurance services.

For example, many insurance contracts are subject to insurance premium tax for instance in Germany rather than VAT. Therefore, the insurance customer is burdened by the insurance premium tax in the same amount. However, life insurance or pension benefits are exempted from the German insurance premium tax, thus the price reducing advantages of the VAT exemption are in place.

Question 38: *To what extent do you agree or disagree with the following statement: The lack of input tax deduction is detrimental to the financial and insurance sector. It compels the sector to outsource services which are typically provided in-house, thus raising the costs.*

- Strongly agree
- Agree
- Neutral
- Disagree
- **Strongly disagree X**
- Do not know

PensionsEurope explanation:

We agree that the lack of input VAT deduction is detrimental to the financial and insurance sector. However, this does not lead to a pressure on outsourcing services that are normally provided in-house.

[2] The test that considers a pension fund to be comparable to a UCITS and therefore falls within the scope of the exemption of art. 135(1)(g) of the VAT Directive, if the following conditions are met:
- the fund is subject to specific State supervision;
- it is funded by the persons to whom the retirement benefit is to be paid;
- the savings are invested using a risk-spreading principle; and
- the pension customers bear the investment risk.

Rather, the opposite is the case: burdening external services with VAT (without the possibility of deducting it) while internal services are naturally not subject to VAT, leads to a comparative disadvantage for outsourcing solutions.

Question 41: *The VAT treatment of emerging trends under the current VAT rules for financial and insurance services can be problematic due to unclear definitions for VAT purposes. In connection with which of the emerging trends listed, do you consider this correct?*
Multiple answers possible

- Services provided by means of fintech
- E-money
- Services linked to crypto-assets (such as mining)
- Payment services
- **Other X**
- Do not consider it problematic
- Do not know

Question 42: *Please indicate which other trend(s):*

PensionsEurope answer:

The jurisdiction of the CJEU during the last decade has created a large legal uncertainty, whether the management of pension schemes can still enjoy the exemption of Art. 135 para. 1 g) CVSD. Reference is made to the cases C-424/11 Wheels Common Investment Fund Trustees, C-464/12 ATP PensionServices, C-275/11 GfBk. Though at a first glance the criterion of the CJEU, who bears the risk of the investment seems to be a clear criterion, such criterion in its practical application provides for unsurmountable difficulties, e.g. in cases, where the pensions paid to former employees by a pension fund depend on age and salaries on the one hand (risk with the employer) though also on reference interest rates or earnings made by the pension fund. Thus, the exemption of Art. 135 para. 1 g) CVSD shall not depend on that risk criterion but only on the nature of pension fund as special investment fund as defined by the Member State. As stated above, the exemption of the administration of pension schemes should be irrelevant of the type of benefits that the pension schemes offer. The comparison with "normal" investment funds is not adequate and the purpose of the VAT exemption should clarify that the administration of pension schemes itself is exempted (and not only if it is comparable to a special investment fund in the meaning of an UCITS).

Question 44: *In your view, which would be the best way to reform the rules on exemption?*
Multiple answers possible

- Update definitions of exempt services drawing on the extensive CJEU case law in the field of VAT
- **As regards the definitions, refer to other EU regulations governing the financial and insurance sector X**

- Removing the exemption, so that definitions will be no longer needed
- Other

PensionsEurope explanation:

The supply of services related to the professional workers, sector or company pension scheme should remain fully exempt from VAT to avoid a double taxation of VAT and insurance tax. Since the EUGH CJEU case law had to decide the VAT exemption on the basis of the existing legal situation, an adjustment of the VAT rules to the EUGH CJEU case law does not appear to be expedient. In this respect, the supply of services that are to be subject to VAT exemption should refer to the existing definitions in the local legislations for the finance and insurance sector. Any adjustments to the definitions in these local legislations would then be covered in the field of VAT automatically. Or, to reduce this kind of legal uncertainty and complexity, a clear and undisputable legal exemption from VAT for pension schemes could be much more effective than disrupting the system of relevant VAT exemptions in total.

Question 46: *The removal of the exemption for financial and insurance services could benefit the neutrality of the VAT system. What could be other effects of such a removal?*
Multiple answers possible

- Simplification in the application of the VAT rules for financial and insurance
- services
- Lower VAT compliance costs
- Less distortive effect of the exemption on competition linked to suppliers
- from non-EU countries operating in the EU
- Higher VAT compliance costs
- Higher complexity of VAT rules
- None
- **Other X**

Question 47: *Please indicate which other effect(s).*

If VAT exemptions for financial and insurance services would be abolished in a broad manner to create "VAT neutrality" this would at the end lead to an increase in cost and a reduction in benefits for beneficiaries because the cost decrease under way for purchased preliminary products and services will not outweigh the likely increase due to the abolition of VAT exemptions. A blanket abolition of VAT exemptions would have far-reaching negative consequences that are not addressed in the Commission's consultation. If the VAT exemption were to be extensively abolished, pension funds would have considerable negative effects on their contribution side on the one hand and in asset management through investment funds on the other side. The theoretically possible cost savings in the upstream supply chain mentioned in the roadmap will not outweigh the additional costs at the level of the pension scheme, and the transfer of the cost savings is clearly dependent on the market power of the actors involved.

About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace and other funded pensions. Some members operate purely individual pension schemes. PensionsEurope has **24 member associations** in 17 EU Member States and 4 other European countries[3].

PensionsEurope member organisations cover different types of workplace pensions for over **110 million people.** Through its Member Associations PensionsEurope represents more than **€ 4 trillion of assets** managed for future pension payments. In addition, many members of PensionsEurope also cover personal pensions, which are connected with an employment relation.

PensionsEurope also has **25 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

What PensionsEurope stands for

- A regulatory environment encouraging workplace pension membership;
- Ensure that more and more Europeans can benefit from an adequate income in retirement;
- Policies which will enable sufficient contributions and good returns.

Our members offer

- Economies of scale in governance, administration and asset management;
- Risk pooling and often intergenerational risk-sharing;
- Often "not-for-profit" and some/all of the costs are borne by the employer;
- Members of workplace pension schemes often benefit from a contribution paid by the employer;
- Wide-scale coverage due to mandatory participation, sector-wide participation based on collective agreements and soft-compulsion elements such as auto-enrolment;
- Good governance and alignment of interest due to participation of the main stakeholders.

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[3] EU Member States: Austria, Belgium, Bulgaria, Croatia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden. Non-EU Member States: Iceland, Norway, Switzerland, UK.