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INDIRECT TAXES ON FINANCIAL OPERATIONS

THE CONCEPT OF FINANCIAL OPERATION

Financial operations in relation to national and Community laws: lack of a standard definition of the financial activity

An examination of the tax regime which applies to financial operations poses, as a first question, the one concerning the lack of a standard legal definition of the financial activity.

Even if said problem is also found at national level, it is especially evident at Community level where the financial activity is defined only in economic terms and not legal ones.

The situation described above appears particularly significant for the purpose of this paper, if we consider that the disciplining of financial and investment services is one the essential conditions for the realization of a common market within the European Union. At the same time, it is rather problematic given that, if from a certain perspective it appears correct to focus the study on the concept of “*financial activity*” rather than “*financial operation*”, under a different profile, exempted operations often assume an independent consistency with regards to the exempted activity.

VAT EXEMPT FINANCIAL OPERATIONS

The exemption regime, the principle of tax neutrality and waivers to the right of deduction

The regime of exemptions assumes a basic significance in the value added tax (VAT) system in terms of the strong impact that said regime has on the principles which characterize the functioning of said tax, among which, the first one to stand out is the principle of tax neutrality.

In fact, the peculiarity of VAT tax – conceived as a “multi-phase” tax – is that, through the mechanism of “*deduction – shifting of the tax*”, the tax implication *vis à vis* economic operators (legal taxable person) is kept neutral, and is transmitted to the end user (also denominated the *de facto* taxpayer); who, therefore, under the economic profile, is the person actually “*affected*” by the tax.

Exempted operations, unlike those excluded from tax which are unimportant in the system under examination – and like those which are non-taxable, have their own significance which is both formal and material with regards to VAT, even if they do not determine the origin of the relative tax obligation.

Unlike non taxable operations, however, exempted ones determine a strong limitation for the right of VAT deduction made on disbursements (whose percentage is calculated using the so-called *pro-rata* mechanism described in art. 19 of the VAT law), with the result that the exemption regime appears less convenient than the one of non taxability.

Essentially, exempted operations appear unfavourable for a company on those occasions where the same must make significant disbursements for their execution; and this, due to the limited (or excluded) deductibility of the relative VAT paid at source.

This type of unfavourable situation – which especially affects companies operating in sectors (such as the financial one) characterized by the execution of operations which are prevalently and exclusively exempted – may also have negative repercussions on the end users; since, the VAT which is not deductible at the source, becomes a cost for the company and is generally transferred onto the price of the goods or service provided.

Under a different profile, we cannot deny that since VAT is a “Community” tax, the correct treatment of the subject implies constant reference to the corresponding Community laws, as in the interpretation provided by the Court of Justice.

In fact, art. 10 of the VAT Decree which practically contains all the laws regarding VAT exemptions, constitutes the direct implementation of the corresponding Community provisions contained in Title IX, chapter I of Directive 2006/112EC.

In order to adequately recognize the operations which belong in the category under examination, the European Court of Justice requires the use of a type of teleological reasoning, mainly (if not exclusively) centred on the purpose of the operation, rather than on the person establishing it.

The cases of exemption disciplined by the aforementioned art. 10 relate to: i) loans and financing operations; ii) securities and guarantees; iii) deposit operations regarding funds and payment services; iv) operations relating to foreign currency; v) operations relating to securities and company shares; vi) operations relating to terms of reference, brokerage and intermediation of exempted financial operations; as well as those relating to investment gold.

CHARGES CONNECTED WITH THE OUTSOURCING OF SEGMENTS OF INSTRUMENTAL ACTIVITIES BY EXEMPTED PERSONS

The effects of the financial and insurance reform for groups with exempted activities: the critical points

Art. 6 of Law no. 133 of 13 May 1999 introduced a specific system of exemptions for services provided in relation to activities which are of an ancillary nature in comparison with those actually carried out by companies of banking and insurance groups, as well as those performed by groups of companies whose activities are primarily exempt provided by companies belonging to the groups themselves.

Said regime had helped to eliminate, or at least mitigate the distorting phenomena connected to the procedure, especially followed by the banking and insurance groups (and in general, by persons who, by pursuing VAT exempt activities, are not generally allowed to collect the tax withheld at the source) to outsource those services which are ancillary to the main activity.

Before said reform in fact, the use of “outsourcing” was penalised when compared with the choice of performing the services inside the company, and this, for the very reason that VAT paid by the aforementioned entities on “outsourced” services, thus resulting non deductible, translated into a cost for the company.

Decree-Law no. 112 of 25 June 2008 converted with amendments, into Law no.133 of 6 August 2008 made important amendments, mainly negative ones, to the previous tax regime regarding the banking, financial and insurance sectors.

In particular, the Legislator of the reform repealed the previous regulations such as the aforementioned art. 6 of Law no. 133/1999, inserting, at the same time, a new paragraph 2 [very similar to the previous paragraphs 1, letter b) and paragraph 3, letter b) mentioned in the law] in art. 10 of Presidential Decree no. 633/1972, according to which: *“Exemption from tax also applies to those services provided by consortium members or partners of consortiums including consortium companies and cooperative companies with consortium functions, incorporated among persons for which in the previous three years, the percentage of the deduction indicated article 19-bis, also due to the option indicated in article 36-bis, was less than 10% on condition that the considerations due by the consortium members to partners of the aforesaid consortiums and companies do not exceed the costs attributable to the services themselves”*.

The aforementioned repealing of the previous regime has brought about a tax spill-over effect with a strong impact both for persons operating in the financial sector as well as for the non-realization of the Community institution of origin of the so-called “sole VAT taxpayer” (also known as VAT grouping).

Under the first profile, the far reaching effects of the reform may be easily seen if we consider that the almost total cancellation of the provisions of the previously existing art. 6 of Law no 133/199, in the absence of a contextual implementation of the Community provisions contained in said text – has re-proposed the same problems which the aforementioned art. 6 had partially remedied.

In fact, in cancelling the exemption for the majority of services outsourced by banking and insurance groups, with the exception of those services linked to a consortium type scheme, art. 10 seems to have taken a step back in comparison to the past.

Moreover, the possibility of using the new regime, constricted and conditioned by strong limitations which, as highlighted in renowned case law are “*of such proportion as to doubt the actual possibility of operating the same in cases other than those where the organizations therein provided have already been experimented*”, is considered a further opposing factor to the necessity of avoiding an undue burden for VAT which is not deductible on services related to exempted activities for VAT taxpayers.

In fact, following the reintroduction of the application of VAT for “outsourced” operations, the problems of the system connected with said procedure – whose effects had been eliminated or, at least, mitigated as a result of the previous reform – reappeared in the same way as in the past, with the subsequent revival of the relative discussions concerning the correlated needs for equalization.

In particular, the interference of the newly introduced regime, at least with reference to operators of the financial sector, is evident both an annulment of the economic efforts sustained in implementing the previous outsourcing process, as well as a further burden of costs to be borne for the adaption of the previous structure (consolidated in a period of ten years) on the basis of the consortium model; which now represents the only remedy to avoid the distorting phenomena which have been reintroduced.

Moreover, the situation described above not only affects the efficiency of the functioning of the VAT mechanism, but has important repercussions on the entire financial system and, in particular, on the cost of services sold to the end user who would bear, as already in the past, the weight of the non deductible VAT on purchases at source.

Also under this profile therefore, the abrogation described above, being in contrast with the logic at the basis of the inspiring motivation to make all financial services exempt from VAT, in almost totally suppressing the previous system of exemption for financial and insurance groups, and in the absence of a contextual introduction of a substitute regime, in the writer’s opinion, appears not only unjustified but also untimely.

In any event, the previous assumption appears to be supported by the proposal to include a new art. 137-ter in the VI Directive, according to which the Member States shall be obliged to exempt services provided by a group of taxpayers *vis à vis* members of the same group, on

condition that the group performs an independent activity and acts as an independent person *vis à vis* its members, that the services offered are “*necessary*” to provide the exempted services pursuant to art. 135, paragraph 1, letter a) – g) [as more clearly defined in the aforesaid proposal] and that the members of the group are not only established or resident in the European Community, but provide services according to the aforementioned law, or other services in relation to which they are not taxpayers.

The theory explained above seems to find further support in the European Community proposal dated 20 February 2008, COM(2007) 746 which modifies Directive 2006/112/EC in the part concerning the treatment of insurance and financial services in which it hopes to extend the exemption to the “*provision of any element constituting an insurance or financial service when said element forms a distinct ensemble and presents a specific and essential character of the exempted service in question*”, as well as improve the legal certainty and reduce the administrative charges of the operators and national tax authorities, particularly in relation to a possible negative impact, in terms of an increase in the costs of retail insurance and financial costs.

In this way, in fact, it would be possible to avoid the risk of extending the exemption regime for said activities to operations which, by their very nature, are not exempted; as well as to include taxable intra-group operations which could result in the aforementioned effects for the clients among the essentially exempted services.

The implementation of Community provisions in relation to VAT grouping: a missed opportunity

Considering that the newly introduced exemption regime described in the new paragraph of art. 10 relates only to activities linked to the applicability of the VAT regime and that therefore, the same does not apply to the implementation of the Community institution of the single VAT person described in art. 11 of the VI VAT Directive which, instead, excludes the intra-group services from VAT; it seems appropriate to examine not only the reasons, but also the effects (without claiming to be exhaustive, given that this paper only marginally touches on the aforementioned institution) connected with the non-implementation of said institution at the same time as the abrogation.

Under the first profile, we note that the motivations which in 1999 had led the legislator to introduce the specific exemption regime previously described, appeared (from the beginning) to be clear and absolutely comprehensible; instead, the motivations underlying the choice to repeal the regime of exemption from VAT for intra-group operations provided for in the previous regime, did not appear as clear.

In fact, in light of the important effects arising from the partial cancellation of art. 6, said legal choice does not appear completely justifiable on the basis of necessity, moreover, not expressly stated in the preparatory works (which only state that the abrogation is a temporary measure while awaiting the final realization of the Community institution of the single VAT taxpayer), to implement the Community laws on independent associations of persons.

After all, even if Law no. 133/1999 tried to include the Community provisions on VAT grouping, through the progressive increase of the number of persons to whom exemption applies, instead of sanctioning the exemption from VAT of intra-group operations (as indicated in the Community provisions), said intervention seemed appropriate to limit the possibility of any violation procedures against Italy in relation to the absence of the institution under reference.

In this view, if the essential reasons of the abrogation can be widely traced back to the need to implement the Community provisions on independent associations of persons in order not to be contested by the Community Institutions, it is incomprehensible why the legislator, in making the amendments to the previous regime of special exemptions and in keeping with the previous legal interventions, did not also provide a final incorporation of the Community institution which, instead, to date has been postponed.

In other words, **the need for a better application of art. 132 of the VI Directive, not only implies the adaption of the previous provisions on the subject, but also did not seem to impose the contextual and immediate suppression of other provisions which aimed at “purifying” the provision of intra-group services from VAT.**

Even in this view, therefore, there is no justification for the fact that the 2008 Legislator did not also provide for the definitive implementation of the laws relating to VAT grouping, limiting himself to removing some of the more critical aspects of the previous regime [such as, for

example, the unfortunate references to the concept of “ancillary” aspects in art. 59, paragraph 1, letter c), *Testo Unico delle Leggi Bancarie*, eliminated in the new article 10, paragraph 2].

It is evident that the actual setting aside of the implementation in Italy of the aforementioned provisions – understood as the only general remedy for the well-known problem of penalization (borne especially by persons with activities which are prevalently exempted) and connected to the non deductibility of VAT “at source” which is paid for services which are, in any event, related to group activities – not only did not solve the problems which were partially mitigated under the eliminated regime, but almost seemed to have re-proposed them in an even more incisive manner.

Moreover, if the primary need of the reform was to avoid censure by the European Community, even if art. 10 appeared to be more compliant, in relation to the past, with the Community provisions for associations of persons (a theory which is herein denied), the contextual abrogation of the previous regime of exemption of intra-group operations could, in any event, still be contested by the competent Community institutions.

In fact, the suppression of the previous provisions concerning groups with activities which are prevalently exempted, does not allow for the exclusion *a priori*, of a similar procedure which may be undertaken with reference to the non reception, by Italy, of the Community indications in relation to VAT grouping.

This scenario, moreover, appears anything but remote, if we consider that Italy is already in violation and that the Institute under reference has actually been implemented by fourteen Member States, among which, Austria, Belgium, Denmark, Germany, The Netherlands, The United Kingdom and Ireland.

Moreover, the risk of a violation procedure against Italy appears even more realistic in terms of the aforementioned proposal to include the new art. 137-*ter* in the VI Directive, approved by the Council of the European Union together with a regulation by the Council on 6 December 2007 which, if definitely approved – unlike the one related to cost sharing association – should have been implemented by 31 December 2009.

Moreover, we must add that the new art. 10 does not appear to be in compliance with the recommendations of the European Community in the communication of 1 December 2010, COM(2010) 695 which reiterates the need to adapt the VAT system with that of large companies and Pan-European companies, examining the possibility of “*considering the operations of related companies or the provision of goods among branches to be outside the application of VAT*” or to “*increase the geographic extension of the VAT groupings*”.

In this view, if the lawmakers had not wanted to immediately realize the institution of the “single VAT grouping”, in the writer’s opinion, it would at least have been safer to postpone the elimination of the previous regime of exemption of intra-group operations (which, it has been repeatedly stated that, in line with the aforesaid principles had, in any event, undertaken to implement the provisions on the single VAT person), until the actual realization of the institution, in order to avoid, or at least, limit, the possibility of any contestation by the European Community.

Nor in this regard is it possible to object, that the reassurance given in relation to the final implementation of the provisions regarding the single VAT person, in the absence of any precise statement regarding implementation times, can be invoked as a valid justification for the choice made by the Italian Legislator.

In light of the above observations, it is reasonable to maintain that we shall have to wait a long time before seeing the final implementation of the institution of the “single VAT person”; the reform intervention described above appears to be fruit of a hasty choice and, in any event, on the whole, unsatisfactory.

Therefore a prompt revision of the current regime on intra-group operations would seem appropriate, with a definite rethinking in terms of exclusion of the tax, rather than the exemption of the activity performed within the groups of companies which, in this context, would be considered as the single taxpayer.

Only following said definition after all, would it appear realistically possible to claim and guarantee the actual neutrality of the VAT system.

THE “LESSER” TAXES ON FINANCIAL ACTIVITIES

Even if this study essentially examines the distorting phenomena which can still be found in the financial sector, in terms of VAT, a brief examination of the tax “charges” connected with the execution of financial operations cannot be separated from a more succinct overview of the indirect taxes which burden financial activities in Italy.

The various types of taxes provided in this context, in fact, have different cross-border implications and inevitably have considerable repercussions on the efficiency of the markets and the correct use of financial instruments.

It follows that, even in the sector of “lesser” indirect taxes, to a much lesser degree than in relation to VAT (also in consideration of the lesser revenue produced by the lesser charges), the effective disciplining of financial and investment services is an essential condition for the creation of a common market inside the European Community.

The need for simplification in this matter is felt, even more significantly with reference to certain sectors which are particularly important socially (such as, for example, those related to inheritances, or those of bank loans), and which are destined to satisfy public needs.

After all, the above statement is confirmed in the legislative decree for the reform of the national tax system (AS n. 1396-A) which, provides for amendments, not only to the value added tax, but also to the tax system, and particularly, to the declared intention to reduce to the minimum terms the fulfilments required by the taxpayer and at the same time, to allow for significant economies of scale.

It follows, therefore, that the legislator needs, not only to provide a prompt resolution of the VAT distortions connected with the outsourcing phenomena, but to make a further effort in rationalising the residual indirect taxes, the so-called “lesser” ones, which apply to the financial sector.

This type of reform could be implemented, specifically, by means of a drastic reduction of the current tax fulfilments and, in a final analysis, by replacing the remaining “lesser” taxes – or at least, an important part thereof – with the single substitute tax for the same.

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