

Reports and studies commissioned for the Commission

THE TCA SYSTEM – A DETAILED DESCRIPTION INTRODUCTION

This Report (referred to as the “TCA-ADD Report”) contains a detailed description of a modified form of the cash flow system of VAT taxation, referred to as the TCA system, and how it would apply to calculate the VAT payable by a financial institution and its customers on financial services. This Report was prepared as part of a project carried out by Ernst & Young for the European Commission (the “Commission”) to test the application of the TCA system on financial institutions. The objectives of the project were to gain an understanding of the operation of the TCA system and the implications of applying the system to the various financial products offered by financial institutions, and to assess the feasibility of applying the system to actual financial transactions. A total of ten pilots were conducted in the course of the project.

This Report is based upon an approach to the taxation of financial services under VAT developed in the course of this project and in earlier studies by Ernst & Young for the Commission. This paper does not attempt to summarize the discussions in those earlier studies, and is not cross-referenced to them. The pilot studies have led to certain changes in the design features of the system from those described in earlier papers. These changes are incorporated into the system as described in this report.

This Report is organized into the nine chapters. Chapter 1 provides a background as to the development of the TCA system. Chapter 2 provides an overview of the TCA system. It discusses who would calculate the tax, who the tax would apply to, what transactions would be subject to tax, and how the tax would be calculated.

For purposes of this report, the financial transactions entered into by financial institutions have been divided into six groups - customer loans and deposits, security transactions, derivative transactions, life and general insurance, debt securities issued by financial institutions, and other assets. Each of these is discussed in Chapters 3 to 8 of the report.

Chapter 3 discusses the taxation of customer loans and deposits, including the application of the TCA system to foreign currency loans and deposits, home mortgages and credit cards. Chapter 4 provides an overview of the types of security transactions undertaken by financial institutions, the application of VAT to these transactions, and the implications of applying VAT to these transactions. Chapter 5 provides an overview of the types of derivative transactions undertaken by financial institutions, how the TCA system would apply to these transactions, and the implications of applying VAT to these transactions (including hedging of retail banking operations).

Chapter 6 discusses the taxation of both life and general insurance policies and the implications on pricing of these policies. Chapter 7 discusses the taxation of debt securities issued by the financial institution, and bearer securities in particular. Chapter 8 discusses the taxation of other assets of the financial institution.

Chapter 9 contains a comparison of the TCA system with the normal VAT system.