

VAT Survey Financial Services

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Survey on the recovery of input VAT in the financial sector
December 2006

1	Introduction	6
2	Executive Summary	9
3	Definition	15
4	Austria	16
	4.1 Legal provisions relating to deduction of input VAT	16
	4.1.1 General overview of exemptions according to the domestic law	16
	4.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	16
	4.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	17
	4.3 Actual rate of deduction of input VAT in the financial sector	17
5	Belgium	18
	5.1 Legal provisions relating to deduction of input VAT	18
	5.1.1 General overview of exemptions according to the domestic law	18
	5.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	18
	5.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	18
	5.3 Actual rate of deduction of input VAT in the financial sector	21
6	Bulgaria	22
	6.1 Legal provisions relating to deduction of input VAT	22
	6.1.1 General overview of exemptions according to the domestic law	22
	6.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	22
	6.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	22
	6.3 Actual rate of deduction of input VAT in the financial sector	22
7	Cyprus	23
	7.1 Legal provisions relating to deduction of input VAT	23
	7.1.1 General overview of exemptions according to the domestic law	23
	7.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	23
	7.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	24
	7.3 Actual rate of deduction of input VAT in the financial sector	24
8	Czech Republic	25
	8.1 Legal provisions relating to deduction of input VAT	25
	8.1.1 General overview of exemptions according to the domestic law	25
	8.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	25
	8.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	26
	8.3 Actual rate of deduction of input VAT in the financial sector	26
9	Denmark	27
	9.1 Legal provisions relating to deduction of input VAT	27
	9.1.1 General overview of exemptions according to the domestic law	27
	9.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	27
	9.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	28
	9.3 Actual rate of deduction of input VAT in the financial sector	29
10	Estonia	30
	10.1 Legal provisions relating to deduction of input VAT	30
	10.1.1 General overview of exemptions according to the domestic law	30
	10.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	30
	10.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	31
	10.3 Actual rate of deduction of input VAT in the financial sector	31
11	Finland	32
	11.1 Legal provisions relating to deduction of input VAT	32
	11.1.1 General overview of exemptions according to the domestic law	32
	11.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	32
	11.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	32
	11.3 Actual rate of deduction of input VAT in the financial sector	32
12	France	34
	12.1 Legal provisions relating to deduction of input VAT	34
	12.1.1 General overview of exemptions according to the domestic law	34
	12.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	34
	12.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	36

Survey on the recovery of input VAT in the financial sector
December 2006

	12.3 Actual rate of deduction of input VAT in the financial sector	38
13	Germany	39
	13.1 Legal provisions relating to deduction of input VAT	39
	13.1.1 General overview of exemptions according to the domestic law	39
	13.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	39
	13.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	40
	13.3 Actual rate of deduction of input VAT in the financial sector	41
14	Greece	42
	14.1 Legal provisions relating to deduction of input VAT	42
	14.1.1 General overview of exemptions according to the domestic law	42
	14.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	42
	14.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	42
	14.3 Actual rate of deduction of input VAT in the financial sector	43
15	Hungary	44
	15.1 Legal provisions relating to deduction of input VAT	44
	15.1.1 General overview of exemptions according to the domestic law	44
	15.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	44
	15.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	45
	15.3 Actual rate of deduction of input VAT in the financial sector	47
16	Ireland	48
	16.1 Legal provisions relating to deduction of input VAT	48
	16.1.1 General overview of exemptions according to the domestic law	48
	16.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	48
	16.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	49
	16.3 Actual rate of deduction of input VAT in the financial sector	49
17	Italy	50
	17.1 Legal provisions relating to deduction of input VAT	50
	17.1.1 General overview of exemptions according to the domestic law	50
	17.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	50
	17.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	51
	17.3 Actual rate of deduction of input VAT in the financial sector	52
18	Latvia	53
	18.1 Legal provisions relating to deduction of input VAT	53
	18.1.1 General overview of exemptions according to the domestic law	53
	18.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	53
	18.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	54
	18.3 Actual rate of deduction of input VAT in the financial sector	55
19	Lithuania	56
	19.1 Legal provisions relating to deduction of input VAT	56
	19.1.1 General overview of exemptions according to the domestic law	56
	19.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	56
	19.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	58
	19.3 Actual rate of deduction of input VAT in the financial sector	58
20	Luxembourg	59
	20.1 Legal provisions relating to deduction of input VAT	59
	20.1.1 General overview of exemptions according to the domestic law	59
	20.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	59
	20.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	60
	20.3 Actual rate of deduction of input VAT in the financial sector	60
21	Malta	62
	21.1 Legal provisions relating to deduction of input VAT	62
	21.1.1 General overview of exemptions according to the domestic law	62
	21.1.2 Deduction of input tax in respect of goods and services used for mixed purposes	62
	21.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector	63
	21.3 Actual rate of deduction of input VAT in the financial sector	63
22	Netherlands	64

Survey on the recovery of input VAT in the financial sector
December 2006

	22.1	Legal provisions relating to deduction of input VAT	64
	22.1.1	Preliminary observations	64
	22.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	64
	22.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	65
	22.3	Actual rate of deduction of input VAT in the financial sector	67
23		Poland	68
	23.1	Legal provisions relating to deduction of input VAT	68
	23.1.1	General overview of exemptions according to the domestic law	68
	23.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	68
	23.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	69
	23.3	Actual rate of deduction of input VAT in the financial sector	70
24		Portugal	71
	24.1	Legal provisions relating to deduction of input VAT	71
	24.1.1	General overview of exemptions according to the domestic law	71
	24.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	71
	24.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	72
	24.3	Actual rate of deduction of input VAT in the financial sector	72
25		Romania	73
	25.1	Legal provisions relating to deduction of input VAT	73
	25.1.1	General overview of exemptions according to the domestic law	73
	25.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	73
	25.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	74
	25.3	Actual rate of deduction of input VAT in the financial sector	74
26		Slovak Republic	75
	26.1	Legal provisions relating to deduction of input VAT	75
	26.1.1	General overview of exemptions according to the domestic law	75
	26.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	75
	26.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	75
	26.3	Actual rate of deduction of input VAT in the financial sector	75
27		Slovenia	76
	27.1	Legal provisions relating to deduction of input VAT	76
	27.1.1	General overview of exemptions according to the domestic law	76
	27.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	76
	27.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	78
	27.3	Actual rate of deduction of input VAT in the financial sector	78
28		Spain	79
	28.1	Legal provisions relating to deduction of input VAT	79
	28.1.1	General overview of exemptions according to the domestic law	79
	28.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	79
	28.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	80
	28.3	Actual rate of deduction of input VAT in the financial sector	80
29		Sweden	81
	29.1	Legal provisions relating to deduction of input VAT	81
	29.1.1	General overview of exemptions according to the domestic law	81
	29.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	82
	29.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	83
	29.3	Actual rate of deduction of input VAT in the financial sector	83
30		UK	84
	30.1	Legal provisions relating to deduction of input VAT	84
	30.1.1	General overview of exemptions according to the domestic law	84
	30.1.2	Deduction of input tax in respect of goods and services used for mixed purposes	84
	30.2	Special legislation or administrative practices relating to deduction of input VAT in the financial sector	86
	30.3	Actual rate of deduction of input VAT in the financial sector	86

ANNEX

Austria	88
Belgium.....	89
Bulgaria.....	90
Cyprus	91
Czech Republic	92
Denmark.....	93
Estonia	94
France	95
Germany	96
Greece	97
Hungary	98
Ireland	100
Italy	101
Latvia	102
Lithuania.....	103
Luxembourg	104
Malta	106
Netherlands	107
Poland	108
Portugal	109
Romania.....	110
Slovak Republic	111
Slovenia	112
Spain	113
UK	115

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1 INTRODUCTION

By letter of 1 December 2007, the European Commission requested the IBFD to carry out a survey on the method of deduction of input VAT applied by the Member States in respect of goods and services used by taxable persons in general and by taxable persons operating in the financial sector in particular for the purposes of carrying out both taxable and exempt transactions. The request followed the finding of PricewaterhouseCoopers (see its report of 2 November 2006, 'Study to Increase the Understanding of the Economic Effects of the VAT Exemption for Financial and Insurance Services) that the rate of input VAT recovery for financial institutions ranges from 0% to 74%. The Commission is particularly interested in the factors that may affect the rate of input VAT recovery and, to that end, asked the IBFD to provide information as regards the way the Member States have transposed Article 17(5) into their national legislation and whether or not special legislative provisions or administrative practices affect the rate of input VAT recovery for taxable persons operating in the financial sector.

In conformity with the research assignment, this report provides a description of:

1. the national legislation in the 25 Member States implementing Articles 17(5) and 19(1) of the Sixth Directive. The information is presented under the subheading: *Legal provisions relating to deduction of input VAT*. In this respect, the term "pro rata" refers to the method of deduction, which is based on turnover (see Article 19¹ of the Sixth Directive) and "actual use" or "direct allocation" refers to the method of deduction laid down by Article 17(5)(c)² of the Directive. The term "sectoral approach" or "sectoral pro rata" refers to the methods laid down by Article 17(5)(a), (b) and (d)³ of the Directive;
2. how the 25 Member States actually apply those rules in reality, in particular, if they have significant concessional practices not reflected in the legislation, which have an effect on the eventual right of financial institutions to deduct input VAT. This is a critical point since, in many instances, a description of the implementing legislation may not be sufficient to explain possible variations in the rate of deduction of input VAT by individual institutions established in different Member States. The information is presented under the subheading: *Special*

¹ Article 19 of the Sixth Directive provides:

1. The proportion deductible under the first subparagraph of Article 17(5) shall be made up of a fraction having:
 - as numerator, the total amount, exclusive of value added tax, of turnover per year attributable to transactions in respect of which value added tax is deductible under Article 17(2) and (3),
 - as denominator, the total amount, exclusive of value added tax, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which value added tax is not deductible

² Article 17(5)(c) of the Sixth Directive provides:

5. As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible, only such proportion of the value added tax shall be deductible as is attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person.

However, Member States may:

- ...
- c. authorize or compel the taxable person to make the deduction on the basis of the use of all or part of the goods and services;

...

³ Article 17(5)(a), (b) and (d) of the Sixth Directive provides:

5. As regards goods and services to be used by a taxable person both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible, only such proportion of the value added tax shall be deductible as is attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person.

However, Member States may:

- a. authorize the taxable person to determine a proportion for each sector of his business, provided that separate accounts are kept for each sector;
- b. compel the taxable person to determine a proportion for each sector of his business and to keep separate accounts for each sector;
- c. ...
- d. authorize or compel the taxable person to make the deduction in accordance with the rule laid down in the first subparagraph, in respect of all goods and services used for all transactions referred to therein; ...

legislation or administrative practices relating to deduction of input VAT in the financial sector. For the purposes of this report, 'financial services' comprise the insurance transactions within the meaning of Article 13(B)(a) of the Sixth Directive and banking transactions within the meaning of Article 13(B)(d) of the Directive. For the sake of completeness, Annex 1 to this report provides an overview of how the Member States have transposed those Community exemptions into their national law; and

3. the national average rate of VAT deduction for institutions operating in the financial sectors of the individual Member States, if available, preferably with some sectoral breakdown. The information is presented under the subheading: *Actual rate of input VAT deduction in the financial sector.*

As regards the different rates of input VAT recovery for financial institutions, it should be noted, in the first place, that several Member States (for example, Estonia, France, Germany and Lithuania) enable financial institutions to opt for taxation as regards their exempt financial transactions. The effect of the option for taxation and, consequently, a relatively high rate of input VAT recovery on the financial institution's competitive position clearly depends on the conditions under which the option can be exercised. Where, such as in Germany, the option can be exercised on a case-by-case basis, the financial institution will only exclude from the exemption services rendered to customers entitled to deduct input tax. Under those circumstances, the financial transactions will effectively be free from any burden of VAT. In respect of services rendered to customers who are not entitled to deduct input tax, the exemption will remain in force, which means that the customer effectively bears the financial institution's non-deductible input tax. Where, on the other hand, just like in France, the option for taxation must be exercised in respect of certain categories of services, regardless of the VAT status of the customer, the option has a favourable effect on services rendered to customers entitled to deduct input tax but an unfavourable effect on services rendered to customers not entitled to deduct input tax. Under the option for taxation, the VAT burden on the latter customers will be higher as compared to the situation in which the services were exempt from VAT. Details of the conditions under which the Member States enable financial institutions to opt for taxation of exempt financial services have not been examined in the framework of this assignment. In general, the conclusion must be that a higher rate of input VAT recovery is not necessarily an advantage to the financial institution in question.

In the second place, variations in the rates of input VAT recovery can be explained on the ground that the composition of the institutions' clientele is different: in view of the fact that, under Article 17(3)(c) of the Sixth Directive, financial institutions are entitled to deduct input VAT in respect of goods and services used for the purpose of rendering exempt banking and insurance services to non-EU customers, the institution's input VAT recovery rate logically increases as the number of clients established outside the EU increases as compared to the number of clients established within the EU. Unfortunately, the research has produced no further information as to the composition of the financial institutions' clientele.

In the third place, variations in the rates of input VAT recovery can be explained on the ground that the scope of the exemptions under national law deviates from that of the provisions laid down by the Sixth Directive. For example, portfolio management services are exempt in, for example, Italy, whilst they are subject to VAT in the UK, Ireland, Luxembourg (at the reduced rate of 12%) and Sweden. Also, the transfer of debts to a factoring company, which under the judgment of the European Court of Justice in *MKG*⁴ must be excluded from the exemption for financial services, continues to be exempt from VAT under Italian law, just like securitization transactions are exempt from VAT in Italy. Although Annex 1 to this report presents an overview of how the Member States have transposed the Community exemptions for financial services into national law, a further analysis of the effect of those discrepancies on the financial institutions' rate of input VAT recovery was not part of the assignment.

Finally, differences in the rates of input VAT recovery may also have to be attributed to concessional arrangements applicable to institutions operating in the financial sectors of the various Member States. This report presents an overview of the existing arrangements applicable

⁴ ECJ judgment of 26 June 2003 in *MKG-Kraftfahrzeuge-Factoring GmbH v. Finanzamt Groß-Gerau*, Case C-305/01, [2003] ECR I-6729.

Survey on the recovery of input VAT in the financial sector
December 2006

in the individual Member States to the method of determining the deductible proportion of input VAT borne by goods and services used by financial institutions for transactions in respect of which VAT is partly deductible.

2 EXECUTIVE SUMMARY

As regards the individual Member States, the national legislation implementing the legal provisions on the method of deduction of input VAT incurred by taxable persons for the purpose of carrying out both taxable and non-taxable transactions, and any existing legal or administrative arrangements applicable in this respect to institutions in the financial sector can be summarized as follows. It should be noted that statistical information on the actual average rate of VAT deduction for institutions operating in the financial sectors of the individual Member States is generally not available. From a perspective of competition, the financial institutions generally consider that type of information as confidential.

In **Austria**, deduction of input tax is in principle based on the direct attribution method. The pro rata method and a combination of the pro rata method with the direct attribution method within limits are possible. Furthermore, Austria allows for a choice of different methods for separate sectors of the entrepreneur, with the consent of the local tax office.

No arrangements specifically applicable to financial institutions are available.

In **Belgium**, deduction of input tax is in principle based on the pro rata. However, where the recovery rate resulting from the pro rata deviates from the method of direct attribution based on actual use, the taxable person may be authorized or compelled to apply the actual use method. Where they keep separate accounts for individual sectors of their business, financial companies may be authorized to use the direct attribution method where possible and where that method cannot be applied, to calculate deductible VAT based on special pro rata per sector.

No other arrangements specifically applicable to financial institutions are available. The tax authorities have issued guidelines clarifying the legal provisions.

In **Bulgaria** only the pro rata method has been implemented.

No arrangements specifically applicable to financial institutions are available.

In **Cyprus**, only the pro rata method can be used, on the understanding that a *de minimis rule* applies. Where, for the tax period, non-deductible input tax is less than 50% of the total input tax and less than CYP 100 per month on average, the input tax is fully deductible.

No arrangements specifically applicable to financial institutions are available.

In the **Czech Republic**, only the pro rata can be used.

No arrangements specifically applicable to financial institutions are available.

In **Denmark**, in accordance with Article 17(5)(a) and (b) of the Sixth Directive, the pro rata applies per sector of the taxable person's business.

In 2004, an administrative notice applicable to financial institutions was issued. It does not contain any concessions.

In **Estonia**, implemented the pro rata as the main principle. A combined method of actual use and pro-rata is however available. The taxable person is required to keep separate accounting records for exempt and non-exempt transactions. Upon a request submitted to the tax authority, the taxpayer can use the direct attribution method in one business sector and the pro-rata method in another..

Under certain conditions, taxable persons may opt for taxation in respect of financial services.

No other arrangements specifically applicable to financial institutions are available.

In **Finland**, deductible input tax is in principle determined on the basis of actual use. If it is impossible to establish the deductible proportion on the basis of that criterion, the tax authorities will accept any reasonable estimate.

No arrangements specifically applicable to financial institutions are available.

In **France**, in principle, the actual use criterion is used to determine the deductible input VAT. However, the pro rata must be used in respect of fixed assets. The tax authorities may also authorize taxable persons to apply the pro rata in respect of other goods and services. In

principle, taxable persons may apply different pro ratas to different sectors of their business. However, that option is not available to financial institutions. They must apply a general pro rata applicable to their business as a whole.

Financial institutions are entitled to opt for taxation in respect of designated exempt activities. Once the option is taken up, it applies to all qualifying activities for a minimum of five years.

Under a guideline, the tax authorities accept that, in respect of specific financial transactions, input tax is deductible at a flat rate. The guideline also confirms that, for the purpose of the pro rata, the gross amount of interest must be taken into account, not net interest (i.e. not the difference between interest received and paid). Furthermore, with respect to transactions on derivatives, clarification have been issued for the calculation of the turnover for the purposes of the pro rata.

In **Germany**, the direct allocation method has been implemented as main principle. In particular, if a taxable person makes both exempt and taxable transactions, the deductible input VAT is first determined by attributing it to the turnover to which it economically belongs (i.e. direct attribution). If the expenses which are charged with input VAT are not directly attributable to exempt or taxable turnover, the proportion of deductible input VAT must be "reasonably estimated". In case input VAT cannot be economically attributed, by reasonable estimation, the deductible input VAT may, within the concept of the direct allocation method (and not based on Article 19 of the Sixth Directive), be determined in relation to the turnover derived from taxed transactions to total turnover.

It is worth noting that Germany gives the option to banks and financial institution to subject to VAT exempt financial transaction on transactions by transaction basis (i.e. "cherry picking")

On 12 April 2005, the Federal Ministry of Finance introduced a new concept for input VAT attribution and some concessions have been granted. The main concession in respect of the granting of credit is the one pursuant to which the margin of credit transactions is calculated by deducting the refinancing costs of the bank for the purpose of acquiring the financial means necessary to grant the credit from the amount of interest received by the bank. The second concession provides that this method can apply either as whole or as a to sectors.

In **Greece**, deductible input tax is in principle determined on the basis of the pro rata method. However, provided that the taxable persons keep separate account for each sectors of their business, the tax authorities may authorize or compel them to apply the sectoral pro rata or the actual use methods.

No arrangements specifically applicable to financial institutions are available.

In **Hungary**, only the pro rata can be used for deduction purposes.

Several guidelines have been issued. However, they only clarify the legal system but do not contain concessions for banks and insurance companies.

In **Ireland**, depending on the circumstances, any method can be used to determine the deductible proportion of the input VAT, provided that the Inspector of Taxes accepts the result, i.e. that the recovery rate correctly reflects the actual use of the goods and services. Although the pro rata was traditionally seen as the standard method of apportionment, taxable persons are only entitled to use it if the results correctly reflect the use of the inputs and range of activities. A sectoral approach is allowed provided that separate sectoral records are kept.

No arrangements specifically applicable to financial institutions are available.

In **Italy**, the deductible proportion of input tax is determined on the basis of the pro rata applicable to the business as a whole or on the basis of different pro ratas applicable to different sectors of the business. In addition, taxable persons carrying out mainly exempt activities may give up their right to deduct input tax and, in return, are relieved of their administrative obligations (i.e. they no longer are required to issue invoices or maintain output VAT registers).

No arrangements specifically applicable to financial institutions are available.

In **Latvia**, the deductible proportion of input tax is determined on the basis of the pro rata or, where the taxable person keeps separate records in respect of taxable and exempt transactions, on the basis of the direct use criterion. Input VAT is fully non-deductible, where the value of the

taxable transactions is less than 5% of the value of all transactions. On the other hand, taxable persons are entitled to full input tax deduction, where the value of the taxable transactions exceeds 95% of the total value of all transactions.

Under an administrative guideline, in respect of transactions in financial instruments and securities, the turnover for the purposes of the pro rata is the net margin, i.e. the difference between the proceeds from the transactions and the purchase price.

In **Lithuania**, a *de minimis* rule applies under which input VAT is fully deductible if at least 95% is attributable to taxable activities. In all other cases, the deductible proportion is determined on the basis of the actual use criterion or the pro rata, on the understanding that actual use takes precedence over the pro rata. Even other methods may be used, if accepted by the tax authorities.

Taxable persons may opt for taxation in respect of certain financial services, if rendered to a taxable person.

No arrangements specifically applicable to financial institutions are available.

In **Luxembourg**, the deductible proportion of the input VAT is determined on the basis of the pro rata or on the basis of actual use. However, input VAT is fully deductible under the condition that the calculated pro rata is 90% or more and the fiscal advantage for taxpayers resulting from a non-application of the pro rata method does not exceed 250 EUR for the calendar year in question.

Furthermore, the tax administration may authorize or oblige taxable persons to apply: (i) a direct allocation method based on actual use for the determination of the deductible input VAT; or (ii) divide its activities into various sectors, to which separate pro ratas apply. The administration may also authorize or compel taxable persons, under certain conditions, to determine a special pro rata for each or certain sectors of their enterprise.

No arrangements specifically applicable to financial institutions are available.

In **Malta**, in principle, the pro rata method must be used to determine the deductible proportion of the input VAT. Under the *de minimis* rule, input VAT is fully recoverable where the amount of non-deductible tax is less than MTL 10 multiplied by the number of months/part thereof included in the relevant tax period. Where it turns out that the pro rata does not lead to a fair and reasonable result, the Commissioner may, by notice in writing, permit a taxable person to apply an alternative attribution method. It appears that, to date, no such alternative method has been negotiated with the VAT authorities.

No arrangements specifically applicable to financial institutions are available.

In the **Netherlands**, input tax relating to goods and services used for mixed purposes is deductible under the pro rata or, where actual use of the goods and services deviates from the pro rata, on the basis of actual use. Consequently, deduction on the basis of actual use takes precedence over the pro rata.

As regards deduction of input tax in respect of banking services, a Public Notice provides further clarification. The most important concession contained in that Public Notice is that, in respect of all goods and services used for mixed purposes, the amount of deductible input VAT may be determined on the basis of the pro rata, in so far as those goods and services are used for purposes that are typical for the banking sector. The option to apply the pro rata may be exercised at the discretion of the bank in question. No special rules apply to the insurance sector

In **Poland**, not only the pro rata but, where that method produces an unfair result or the result was affected by incidental circumstances, any other method, including an estimated recovery percentage, may be agreed with the head of the tax office for the purpose of determining the deductible proportion. Where the pro rata percentage is 2% or less, the input tax is fully non-deductible. On the other hand, where the percentage is 98% or more, the input VAT is deductible in full. As an alternative method, an estimated pro rata may be agreed with the head of the tax office. It is required that the agreed pro rata is documented by a protocol.

No arrangements specifically applicable to financial institutions are available.

In **Portugal**, the deductible proportion is in principle determined on the basis of the pro rata. However, the Director General of Taxes may authorize or compel taxable persons to apply the actual use criterion. Under those circumstances, the Director General may impose special conditions aimed at preventing or putting an end to significant distortion of competition. Finally, the General Director is allowed to ignore certain activities if they are an insignificant part of the total turnover.

No arrangements specifically applicable to financial institutions are available.

In **Romania** deductible input tax is in principle determined on the basis of the actual use method. However, where the input tax cannot be apportioned on a direct use basis the pro rata method can be used for the purpose of determining the deductible proportion.

No arrangements specifically applicable to financial institutions are available.

In **Slovak Republic**, the pro rata method is the only method that can be used for the purpose of determining the deductible proportion.

No arrangements specifically applicable to financial institutions are available.

In **Slovenia**, the deductible proportion of the input VAT is determined on the basis of the pro rata or, where the taxable person keeps separate records of his taxable and exempt transactions, on the basis of actual use of the inputs or, where he keeps separate records of the activities carried out in different sectors of his business, on the basis of sectoral pro ratas.

No arrangements specifically applicable to financial institutions are available.

In **Spain**, only the pro rata can be used for the purpose of determining the deductible proportion. However, the pro rata comes in two versions, a 'general' and 'special' pro rata. The general pro rata, which applies to the total amount of input tax, is based on turnover and applies unless the taxable person opts for application of the special pro rata or application of the special pro rata is imposed by the tax administration. Under the special pro rata, VAT on goods and services exclusively used for the purpose of making taxable transactions is fully deductible, whilst VAT on goods and services exclusively used for the purpose of making exempt transactions is non-deductible; only the goods and services used for mixed purposes is deductible under the pro rata percentage. Use of the special pro rata is compulsory if the general pro rata percentage exceeds the special pro rata percentage by 20% or more.

Furthermore, where he conducts activities in different economic sectors, the taxable person must apply special pro rata percentages to each sector, as if they were independent companies. However, where specific goods or services are used in different sectors of activity, the VAT is deductible under the general pro rata. The tax authorities may allow the use of a single percentage of deduction applicable to all sectors, unless such a single percentage would result in an amount of deductible VAT exceeding 20% of the amount which would result from using a separate percentage for each sector.

In respect of transactions in foreign currency used as legal tender and promissory notes and securities, that are not part of their own portfolio, the turnover for the purposes of the pro rata is the net margin, i.e. the difference between the proceeds from the transactions and the purchase price.

In **Sweden**, the pro rata or any other method that produces a reasonable result may be used for deduction purposes. If more than 95% of the input VAT is deductible, the total amount of input tax is deductible in full, unless it exceeds SEK 1,000.

No arrangements specifically applicable to financial institutions are available.

In the **UK**, the standard method of determining the deductible input VAT is the pro rata. However, if that method does not produce a fair and reasonable result, taxable persons may seek approval from the tax authorities to use a "special method", such as that based on the number of taxable and exempt transactions or the number of staff used for taxable and exempt activities. In exceptional circumstances, the tax authorities can direct the use of a particular method.

No arrangements specifically applicable to financial institutions are available.

Survey on the recovery of input VAT in the financial sector
December 2006

	Option to tax financial and/or insurance transactions	Pro rata		Actual use method	Any other method	Actual pro rata
		Pro rata	Sectoral pro rata			
1. Austria ⁵	NO	X ⁶	--	X ⁷	X ⁸	n/a
2. Belgium	NO	X	X	X ⁹	--	n/a
3. Bulgaria	NO	X	--	--	--	n/a
4. Cyprus ¹⁰	NO	X	--	--	--	n/a
5. Czech Republic	NO	X	--	--	--	1%-2%
6. Denmark	NO	--	X	--	--	3%
7. Estonia	YES ¹¹	X	X	--	X	2% - 3%
8. Finland	NO	--	--	X	--	n/a
9. France	YES	X	X	X ¹²	--	n/a
10. Germany	YES	--	--	X ¹³	X	17%
11. Greece	NO	X	X	X	--	0% - 3%

⁵ An option for VAT is available, in respect of goods credit and supply of services of credit card companies.

⁶ Generally, Austria prefers the direct attribution method. Nevertheless the entrepreneur has a choice within limits which method he uses for the division into deductible and non-deductible input tax for a specific assessment period.

⁷ See footnote 5.

⁸ See footnote 5.

⁹ However, in deviation from this main rule, the Minister of Finance may, upon his request, authorize an entrepreneur to exercise his deduction rights according to a direct allocation method based on actual use of (part of) the goods and services. Entrepreneurs can be obliged to use this method if the application of the main rule would result in an unequal levy of taxation. See paragraph E, b) of the relevant country.

¹⁰ *De minimis* rule is provided: if the input VAT attributable to exempt supplies is less than £100 per month on average and is less than 50% of the total input VAT for that period, then the whole input VAT is deemed to be attributable to taxable supplies is less than 100 per months

¹¹ Under certain condition they may opt for taxation. However, it is not possible in case of insurance transactions.

¹² As a derogation to the compulsory direct allocation method the taxpayer may, upon request, be allowed by the French tax authority allowed to apply the pro rata method. When utilised, it is based on the preceding year's turnover.

¹³ However, the input VAT that cannot be attributed neither to exempt or taxable transactions is deducted within the concept of direct allocation method (and not based on Article 19 of the Sixth Directive) based on a reasonable estimation which may finally be determined in relation to the turnover derived from taxed transactions to total turnover.

Survey on the recovery of input VAT in the financial sector
December 2006

	Option to tax financial and/or insurance transactions	Pro rata method		Actual use method	Any other method	Actual pro- rata
		Pro rata	Sectoral pro rata			
12. Hungary	NO	X	X	X	--	5 - 8%
13. Ireland	NO	X	--	X	--	n/a
14. Italy	NO	X	X	--	X	1 - 1.7%
15. Latvia	NO	X	--	X	--	2%
16. Lithuania	YES ¹⁴	X	--	X	--	n/a
17. Luxembourg	NO	X	X	X ¹⁵	--	n/a
18. Malta	NO	X	--	--	X	n/a
19. Netherlands	NO	X	--	X	--	n/a
20. Poland	NO	X	--	--	X ¹⁶	2%
21. Portugal	NO	X	X	X	--	n/a
22. Romania	NO	X	--	X	--	n/a
23. Slovak Republic	NO	X	--	--	--	n/a
24. Slovenia	NO	X	X	X	--	0 – 5% ¹⁷
25. Spain	NO	X	--	--	X	n/a
26. Sweden	NO	X	--	--	X	n/a
27. UK	NO	X	--	X	X	n/a

¹⁴ Under certain condition they may opt for taxation.

¹⁵ This method is allowed as an alternative to the standard method (i.e. the pro rata method).

¹⁶ If agreed with the tax authority

¹⁷ No official figures have been provided. It represents and estimation made based on some figures disclosed by the private sector (i.e. financial institutions)

3 DEFINITION

For each of the 25 Member States, before describing in details the pro rata mechanism implemented a general overview of (i) “exemptions without right to deduction” and (ii) “exemptions with right to deduction”, is provided.

The meaning of exemptions without right to deduction and exemptions with right to deduction is the same for all the 25 Member States, unless otherwise provided in each country:

exemptions without right to deduction: means that the taxable person has no right to recover input tax incurred in connection with certain exempt supplies.

Pursuant to the Sixth Directive these exemptions are listed as exemptions within the territory of the country and include from one hand activities in the public interest (i.e. Article 13A) and, on the other hand, other exempted activities (i.e. Article 13B). The latter includes, *inter alia*, insurance reinsurance transactions and banking and financial transaction.

Exemptions without the right to deduct the input VAT previously paid means that the VAT payer performing the exempt transactions has no right to recover the input VAT previously paid within the course of its business or can only partially recover this input VAT.

exemption with right of deduction (or exempt with credit or zero-rated): means that even if the taxable person is not required to charge VAT on the supply, such person is entitled to recover input tax on purchases and expenses incurred in connection with such supply. Exemption with right to deduction is generally reserved for exports of goods and international services.

4 AUSTRIA

4.1 Legal provisions relating to deduction of input VAT

4.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in different provisions. The main part of the exemptions is provided for by Sec. 6 of the *Umsatzsteuergesetz* 1994 (the Value Added Tax Act of 1994 – the “**Austrian VATA**”).

In line with the provisions of the Sixth Directive, the exemptions are divided into: (i) exemptions without right to deduction and (ii) exemptions with right to deduction. Pursuant to Sec. 6(1) Nr. 8 of the Austrian VATA the insurance and financial transactions fall, in general, within the exemptions without the right of the deduction (see Austria) of input VAT. However, a right to deduct the input VAT is provided if certain financial and insurance services are supplied to an entity located outside the European Union or if they relate to export.

Exemptions provided for are mandatory. However, an option for VAT is available in respect of leasing of immovable property for purposes other than dwelling, goods credit and supply of services of credit card companies.

4.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Sec. 12 Austrian VATA deals with the deduction of input VAT. In principle, an entrepreneur may deduct this input VAT if the goods and services received are used at least for 10% for his business (Sec. 12(1) and 12(2) VATA).

Sec. 12(3) Nr. 1-3 of the Austrian VATA denies input VAT deduction in respect of input VAT incurred on:

- supplied or imported goods used for effecting exempt supplies;
- the supplies of services used for effecting exempt supplies;
- the supply of goods and/or services or the importation of goods to the extent these supplies are connected with supplies having a place of supply outside Austria and provided these supplies would be exempt if they had a place of supply within Austria; however input VAT deduction is possible if there is a coincident option in Austria and in an other Member State and the entrepreneur verifies the application of that option in the other Member State.

Austria does not make general use of the option for taxation with regard to certain financial services provided by Article 13(C)(b) of the Sixth Directive.

Pursuant to Secs. 12(4) and 12(5) of the Austrian VATA, if goods and services are used for mixed purposes, the input VAT incurred must be divided into a deductible and a non-deductible part. The following methods of division into a deductible and a non-deductible part of input VAT are provided for:

- division according to the economic connection with the respective supplies (Sec. 12(4) of the Austrian VATA);
- division according to the pro rata derived from taxable and non-taxable turnover (Sec 12(5)1 of the Austrian VATA); and
- combined methods: attribution on the basis of the economic connection to the extent possible and division according to the turnover (Sec. 12(5)(2) of the Austrian VATA).

Generally, Austria prefers the direct attribution method because of guarantee of neutrality. Nevertheless, the entrepreneur has a choice within limits which method he uses for the division into deductible and non-deductible input tax for a specific assessment period (Para. 2038 VAT Guidelines). The restriction of that free choice is provided for in Sec. 12(6) of the Austrian VATA. The pro rata calculation may not lead to tax advantages when compared to the direct attribution method (Para. 2046 VAT Guidelines). This is the case if the deductible

input VAT calculated according to Sec. 12(5) exceeds the exact calculation according to Sec. 12(4) of the Austrian VATA by more than 5% (but at least EUR 75) or EUR 750.

Finally, Sec. 12(7) of the Austrian VATA provides that the method may be separately chosen for separate businesses of the entrepreneur, however, only with the consent of the local tax office (Para. 2051 VAT Guidelines). The local tax office may make its consent on the recovery of input VAT subject to compliance with specific requirements in order to avoid unjustified tax advantages (Para. 2061 VAT Guidelines).

Sec. 12(5)1 of the Austrian VATA implements the pro rata embodied in Arts. 17(5) and 19(1) of the Sixth Directive. On top of that the Austrian VATA provides for two additional methods: actual use under Sec. 12(4) VATA and a combination of pro rata and actual use under Sec. 12(5)2. This method is only possible within the mentioned limits of Sec. 12(6) of the Austrian VATA. In so far Austria made use of the concessions embodied in Article 17(5) of the Sixth Directive, which authorizes the Member States to compel businesses to apply different pro rata ratios to separate sectors of their business. Thereby, Austria follows the method of direct attribution according to economic use in accordance with Article 17(5)(c) of the Sixth Directive compelling taxable persons to make the deduction on the basis of the use of all or part of the goods and services. Thereby, the Austrian VATA does not provide for a precedence of the pro rata. On the contrary Austria gives precedence to the direct attribution method and allows two other methods within limits.

4.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

No specific concessions are granted for the banking sector.

Secs. 2011-2046 of the VAT Guidelines provides further clarification with respect to the application of the methods of apportionment described in the above paragraph.

Para. 2013 of the VAT Guidelines clarifies that Austrian VATA provides, as a general rule, a direct connection of the expenses with the taxable transactions (Para. 2015 VAT Guidelines). Expenses which can neither be associated with taxable transactions nor with exempted transactions must be treated separately (Para. 2017 VAT Guidelines). In such a case the economic connection must be established; the apportionment shall be made in a way that an "appropriate" result is achieved. For this purpose, business cost accounting and other similar calculations may be used (Para. 2018 VAT Guidelines). However, if the economic connection cannot be directly established, the attribution must be made according to the cost accounting of the entrepreneur. Nevertheless, for the allocation of those expenses the entrepreneur may also make an estimation, depending on the individual circumstances (Para. 2019 VAT Guidelines).

Para. 2031 of the VAT Guidelines remarks that, it is possible to apply the pro rata method to apportion either the entire input VAT or only the input VAT not directly attributable with the direct economic allocation method. Consent of the fiscal authorities to the choice of method by the entrepreneur is not required. However, this method is not applicable if the result would lead to tax advantages (Para. 2046 VAT Guidelines). That means that this method is excluded if the advantage is more than 5% or EUR 750 in comparison with the direct allocation method.

4.3 Actual rate of deduction of input VAT in the financial sector

There are no statistical numbers available with regard to the national average of input VAT recovery rates of companies operating in the financial sector. The results are, *inter alia*, subject to the fiscal secret and therefore not disclosed to the public. Upon request, the Austrian Banking Association deemed this information to be unavailable due to the business secrets of its members.

5 BELGIUM

5.1 Legal provisions relating to deduction of input VAT

5.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Articles 39 to 44*bis* of the “*Wetboek van de Belasting over de toegevoegde waarde/Code de la Taxe sur la valeur ajoutée* (VAT Code 1969) (the “**Belgian VAT Code**”). In particular exemptions with regard to financial and insurance services are provided in Article 44 of the said Belgian VAT Code (see Belgium).

In line with the provisions of the Sixth Directive¹⁸, the exemptions are divided into: (i) exemptions without right to deduction and (ii) exemptions with right to deduction. In general, *inter alia*, financial and insurance transactions belong to the former category and therefore do not entitle the taxable person to a deduction of input VAT. However, a right to deduct the input VAT is provided if specified financial and insurance services are supplied to an entity located outside the European Union or if they relate to export.

5.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

The rules laid down under the Sixth Directive provide that input VAT relating to goods and services is only deductible where those goods and services are actually used for the purpose of carrying out taxable transactions (there must be a direct link between the goods and services and their use for taxable purposes). Article 45(1) of the Belgian VAT Code is based on the principle, that taxable persons entrepreneurs are entitled to deduct input VAT, in so far as they use the goods and services in the course of their economic activities for purposes of carrying out other than exempt (without deduction rights) transactions. Except for some slight differences, the scope of the right to deduct input VAT is generally the same as that under the Sixth Directive.

With respect to mixed transactions, in principle, input VAT is deductible pro rata, based on the following fraction¹⁹:

$$\frac{\text{Total amount of taxable activities}}{\text{Total amount of all activities}}$$

However, in deviation from this main rule, the Ministry of Finance may, upon the taxable person's request, authorize that person to exercise his deduction rights according to a direct attribution method based on the actual use of (part of) the goods and services. Taxable persons can be obliged to use this method if the application of the main rule would result in an unequal levy of taxation²⁰.

5.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

Belgian administrative practice concerning the calculation of the pro rata is regulated by a Royal Decree²¹ (the “**Decree**”).

The Decree provides that the general pro rata is calculated on the basis of a fraction of which the numerator is equal to the total amount of the activities carried out during a calendar year for which a right to deduct input VAT exists and the denominator is equal to the amount of all activities of the calendar year concerned²². The pro rata is expressed as a percentage, rounded up or down to the higher or lower half-unit.

¹⁸ As amended by Directive 2006/112/EC

¹⁹ Art. 46(1) VATC.

²⁰ Art. 46(2) VATC and Circular No. 103/1970 of 31 December 1970, published at Fisconet. § 89.

²¹ Royal Decree No. 3 (*Koninklijk Besluit no. 3 met betrekking tot de aftrekregeling voor de toepassing van de belasting over de toegevoegde waarde/Arrêté Royal relatif aux déductions pour l'application de la taxe sur la valeur ajoutée*, Art. 12-21).

²² Art. 12(1) and (2) of the Royal Decree. no. 3.

In addition the Decree specifies that the following amounts may not be taken into account for the calculation of the general pro rata²³:

1. the amount of turnover attributable to sales of business assets;
2. the amount of turnover attributable to real estate and financial transactions, unless these transactions constitute, as such, a specific economic activity exercised by the taxable person; and
3. the amount of transactions abroad if these are carried out by an office established abroad, which is distinct from the office established in Belgium and provided the costs regarding those activities are not born directly by the office established in Belgium.

For each calendar year, the pro rata is fixed provisionally on the basis of the supplies of the preceding year²⁴. However, where data for the preceding year are either not available or not relevant, a pro rata is provisionally estimated by the taxable person according to its business projections. The definitive pro rata for a given calendar year is established before the 20th of April of the subsequent calendar year (on the basis of the final data for the given year)²⁵.

The deductible amount of input VAT must be adjusted by comparing the provisional and the final pro rata each year²⁶. When the difference between the two proportions is less than 10%, the taxable person is not obliged to adjust the deduction. This dispensation is optional but once made, it must be continued for at least five successive years.²⁷ The waiver does not apply when the provisional pro rata has been estimated by the taxable person.

Further, the Decree provides that the taxable person who is authorized or obliged to apply the direct attribution method must also make an adjustment if the goods and services that should have been used for transactions subject to VAT are actually used for exempt transactions without the right of deduction²⁸.

In case the goods and services are used for a department carrying on exempt activities the deducted input VAT must be (partially) paid back, whereas the taxable person may be entitled to an additional deduction of input VAT if the goods and services are used for a department involved in taxable activities.

Special circular on the pro rata of banks and financial institutions

To reflect the special position of banks, the Belgian Ministry of Finance has provided further clarifications with respect to the application of the pro rata method in an administrative circular of 1995 (the "**Circular**"), which specifically deals with the deduction of input VAT by banks and financial institutions²⁹.

This Circular was the result of the fact that the European Commission in 1993 held that the Belgian pro rata rules applied to banks were incompatible with Article 19(1) of the Sixth Directive. Until then, indeed, with respect to credit supply, banks only had to include in their taxable turnover the difference between the interest received and the interest paid.

In accordance with the Circular, as from 1995, Belgian banks and financial institutions providing credits, have to include the gross amount of interest received as part of the turnover that constitutes the denominator of the formula for the calculation of the pro rata method.

The Circular, with specific reference to banks and financial institutions, distinguishes the following activities:

1. taxed activities, certain activities abroad and exempt activities for which input VAT is fully deductible³⁰, and including operations concerning payment and receivables for which the option to tax has been exercised³¹;

²³ Art. 13 of Royal Decree no. 3.

²⁴ Art. 15 (1) of Royal Decree no. 3.

²⁵ Art. 15(2) of the Royal Decree no. 3.

²⁶ Art. 16 of Royal Decree no. 3.

²⁷ Art. 17 of Royal Decree no. 3.

²⁸ Art. 19(1) of Royal Decree no. 3.

²⁹ Circular of 26 July 1995 no. 10.1995, published in the VAT Revue no. 115, p. 729.

³⁰ Art. 45(1)(1),(3)-(5) VATC.

³¹ Art. 44(3)(8) VATC.

2. exempt activities for which input VAT is non-deductible in all situations; and³²
3. transactions which are outside the scope of VAT, e.g. the collection of dividends received for the holding of financial interests in other companies or shares of other companies by a holding company³³.

The Circular confirmed that also banks and financial institutions may apply for (i) the general pro rata method and/or (ii) the direct allocation method based on actual use.

The general pro rata is that provided for by Article 46(1) of the Belgian VAT Code, as described above. However, specific guidelines for financial services are provided:

- the gross-amount of interest received must be reported as turnover for credit transactions;
- the dividends and interests received on own stock portfolio may not be included in the numerator and denominator of the fraction for the calculation of the general pro rata;
- with respect to the sale of shares for own account only the difference between the purchase and sales price must be reported as turnover for the calculation of the general pro rata;
- with respect to the sale of shares and exchange transactions for the account of third parties (where the bank or financial institution only acts as an intermediary), the turnover is equal to the difference between the sales and purchase value increased with the commission fee and allocated costs; and
- the exchange transactions for own account may not be included in the numerator and denominator for the calculation of the general pro rata.

The tax administration has issued strict rules for the implementation of the direct attribution method. In fact, this method is only allowed with respect to specific secondary sectors of activity for which full deduction of input tax is possible and which can be clearly distinguished from the other activities of the financial institution. However, direct attribution may also be applied for parts of the core activity of the financial institution upon the condition that the costs related to such parts can be clearly separated from the costs related to the core activity. It is worth noted that financial companies are required to keep separate accounts for each sector of activity and, therefore, are allowed to calculate the deductible VAT separately for each of these sectors.

The use of the direct attribution method is, however, subject to preliminary authorisation by the head of the competent VAT control office. The authorisation will only be effective as from 1 January of the year following the request to apply this method. In its request the financial institution has to specify for which of its secondary activities it intends to apply the direct attribution method and which verifiable apportionment keys are used with respect to costs that are not used exclusively for such activities. In addition, the financial institution has to indicate whether it intends to apply the method to part(s) of its core business or to IT related inputs also. In the latter case, the institution must keep account of computer time used in such a way that computer time can be verifiably attributed to specific activities.

With respect to activities for which the direct attribution method cannot be used, the deductible VAT must be calculated by the financial institution using a special pro rata. The calculation method of this special pro rata is not necessarily the same as the one for the general pro rata; thus, in principle, the special pro rata only refers to the amounts of turnover for which the direct attribution cannot be used but in special cases, turnover of sectors to which direct attribution applies may have to be taken into account. Alternatively, the special pro rata can be based on the number of days the input has been used, on square metres of office space used for a specific activity, etc.

Banks and financial institutions periodically have to submit a profit and loss account to the Commission for Banks, Finance and Insurance Institutions (*Commissie voor het Bank-, Financie- en Assurantiewezen*).

³² Art. 44 VATC.

³³ Case C-333/91 *SATAM*.

5.3 Actual rate of deduction of input VAT in the financial sector

There are no statistical data available with regard to the national average of input VAT recovery rates of companies operating in the financial sector. The results are, *inter alia*, subject to the fiscal secrecy and are therefore not disclosed to the public. Upon request, the Belgian Banking Association deemed this information to be unavailable due to the business secrets of its members.

6 BULGARIA

6.1 Legal provisions relating to deduction of input VAT

6.1.1 *General overview of exemptions according to the domestic law*

Exemptions from VAT are contained in Articles 46, 47 and 50 of Bulgaria VAT Act of 2007 (the "**Bulgarian VAT Act**"). In particular exemptions with regard to financial and insurance services are provided in articles 46 and 47 of the said Bulgarian VAT Act (see Bulgaria).

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, financial services belong to the former category and therefore do not entitle the entrepreneur to a deduction. However, a right to recovery of input VAT is provided if the recipient is established outside the European Community.

6.1.2 *Deduction of input tax in respect of goods and services used for mixed purposes*

Article 73 of the Bulgarian VAT Act provides that a taxpayer has right to deduct a partial credit for input tax in respect of the tax on goods or services which are used for effecting of both supplies in respect of which credit for input tax is deductible and exempt supplies or activities. Therefore, if a taxable person uses goods and services for the purposes of both taxable and exempt supplies (mixed transactions), the input VAT shall be deducted partially. Partial deduction shall be based on the proportion of the turnover the taxable person has generated from transactions where the input VAT can be deducted, to the total turnover (proportion of taxable turnover to total turnover). The proportion is calculated as a ratio with:

- **numerator**, the turnover attributable to the supplies in respect of which credit for input tax is deductible (including the exemptions with the right to deduction);
- **denominator** the turnover attributable to all supplies and activities effected by the person.

The factor shall be calculated on the basis of the turnovers for the entire preceding calendar year and, where there are no such turnovers for the preceding calendar year, on the basis of the turnovers for the tax period during which credit for input tax becomes deductible.

Indeed, in Bulgaria the deductible input VAT is determined on the basis of the pro rata method.

6.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no other rules or guidance concerning the deduction of input VAT in addition to the above provisions of the VAT Act. There are also no known concessional practices deviating from the law that the tax authorities would use with respect to financial services companies. This means that also the financial sector companies must follow exactly the same rules as any other companies. There are no specific rules related to the calculation of pro rata for financial sector companies.

No public clarifications have been provided on how to calculate the turnover of financial services for the purposes of applying the pro-rata. It is possible that individual clarifications have been provided about the application of the rules to actual circumstances. However, these clarifications are not public.

6.3 Actual rate of deduction of input VAT in the financial sector

For all the credit institutions (banks) the proportion of the taxable turnover to total turnover in There are no statistical numbers available with regard to the national average of input VAT recovery rates of companies operating in the financial sector.

7 CYPRUS

7.1 Legal provisions relating to deduction of input VAT

7.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Articles 25 and 26 and in Table B of Schedule 7 of Cyprus Value Added Tax Law of 2000 (the "**Cyprus VAT Law**"). In particular, exemptions with regard to financial and insurance services are provided in Article 25 of the said Cyprus VAT Law (see Cyprus)

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

Further, there is no provision in the Cyprus VAT Law which allows a person to waive the exempt status of a supply and treat it as if it were taxable.

7.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Article 21 of the Cyprus VAT Law states that the amount of input VAT³⁴ for which a taxable person is entitled to recover at the end of any period shall be so much of the input tax for the period that is attributable to the taxable supplies³⁵ made by the taxable person in the course or furtherance of his business.

Regulations 62-74 of the General VAT Regulations 314/2001-2004 have been issued giving guidance on the recoverable amount of VAT when a taxable person is engaged in both taxable and exempt activities.

Regulation 63 states that no provision in these regulations can be interpreted as giving the right to a taxable person to deduct input VAT on goods or services acquired/imported when these goods/services are not used or will not be used by that person in the course or furtherance of his business.

Regulation 64 provides that:

1. Input VAT suffered which is attributable directly and exclusively to the provision of taxable supplies is recoverable.
2. Input VAT suffered which is attributable directly and exclusively to the provision of exempt supplies is not recoverable.
3. Input VAT suffered, which is attributable to both taxable and exempt supplies, is recoverable based on the ratio of (i) taxable supplies over (ii) total supplies (i.e. the general pro rata).
4. When calculating the pro rata ratio, the following transactions are excluded when they are auxiliary to the taxable person's main activities:
 - (i) sale / rental of immovable property;
 - (ii) transactions falling under paragraph 3, table B of the Seventh Schedule of the VAT Law (financial services);
 - (iii) sale of used items/cars or items of art collections;
 - (iv) self supplies.

³⁴ Article 19 of the Cyprus VAT Law states that "input VAT" means any VAT arising from:

- (i) the acquisition of goods and services in Cyprus;
- (i) the intra-community acquisition of goods from other EU Member States;
- (ii) the importation of goods from third countries.

Provided that these goods and services are used or intended to be used for a business activity carried out.

³⁵ Including (i) supplies outside Cyprus that would have been taxable supplies if made in Cyprus; and (ii) certain exempt supplies provided outside EU

5. The pro rata ratio is expressed as a percentage and if this percentage is not an absolute number, it is rounded up to the next absolute number.

Regulation 65 states that a taxable person can use a method other than that described in this regulation, provided that he has obtained prior approval from the VAT Commissioner.

Regulation 66 provides that input VAT related to:

- (a) supplies outside the Republic that would have been taxable if where made within the Republic.
- (b) supplies falling under Article 21(2)(c) of the Cyprus VAT Law (exempt transactions provided to non EU entities)

is attributable to taxable supplies.

Regulation 68 provides that when the input VAT attributable to exempt supplies is less than £100 per month on average and is less than 50% of the total input VAT for that period, then the whole input VAT is deemed to be attributable to taxable supplies (*de minimis rule*).

7.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

The provisions for the right to deduct input VAT in the financial sector have been introduced as from 1 May 2004 in Article 21(2)(c) of the Cyprus Vat Law. Under these provisions, that have retroactive effect as from 1 February 2002, taxable persons have the right to deduct input VAT suffered in the course or furtherance of his business on financial activities falling under the Seventh Schedule, Table B, paragraphs 1 and 3(a)-(e) when provided to:

- (a) Customers situated outside Cyprus for the period 1 February 2002 to 30 April 2004.
- (b) Customers situated outside EU for the period as from 1 May 2004.

The VAT Authorities have issued the VAT Circular 92 dated 12 August 2004 analysing the provisions of the Cyprus VAT Law on this issue (i.e. explaining the provisions of the regulations 62-74 as analysed above).

As these provisions have recently been incorporated in the Cyprus Legislation they have not been tested for a long time. However, the current practice applied by the VAT Authorities is in line with the legislation and no deviations have come to our knowledge.

7.3 Actual rate of deduction of input VAT in the financial sector

The national average rate of VAT deduction is not publicly available by the VAT Authorities or the Statistical Department of the Cyprus Government.

Based on our knowledge, we believe that the actual rate of deduction of input VAT in the financial sector in Cyprus should be rather high due to the fact that many Cyprus entities are providing financial services to non EU Eastern Europe's countries (e.g. Russia, CIS countries etc) or to neighbouring third countries (e.g. Lebanon). This result in the percentage of financial services provided to non EU entities compared to those provided to EU entities being relatively high and therefore the recoverable input VAT to be high.

However, as these provisions were recently introduced into the Cyprus VAT Law, the VAT Authorities have not examined many VAT refund requests filed by Financial Services Companies.

8 CZECH REPUBLIC

8.1 Legal provisions relating to deduction of input VAT

8.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Articles from 51 to 62 of *Zákon c. 235/2004* (the "Czech VAT Act"). In particular exemptions with regard to financial and insurance services are provided in Article 54 and 55 of the said Czech VAT Law (see Czech Republic)

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

Article 95 of the Czech VAT Act provides that persons who provide only exempt supplies without credit may not register for VAT purposes. However, such persons become "persons identified for the VAT" if they receive "intellectual" services (Article 9(2)(e) of the Sixth Directive) from EU and non-EU suppliers.

8.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

The rules implementing the principles of the Sixth Directive in the Czech VAT Law in respect of entitlement to VAT deduction are contained in Article 72 and the following of the Czech VAT Act.

The general principle contained in paragraph 1 of Article 72 provides that the main condition for claiming the VAT deduction is that the VAT payer uses the taxable supplies received for realization of its economic/commercial activities.

In particular, VAT can be deducted in full if the taxpayer uses the incoming supplies to effect exclusively one or more of the following:

- taxable supplies;
- VAT-exempt supplies with the right to VAT deduction;
- supplies rendered as part of the taxable person's business where the place of supply is outside the Czech Republic, on condition that the supplier would be entitled to claim a deduction of input VAT in respect of these supplies had they been supplied in the Czech Republic;
- certain exempt supplies without credit provided to a person established outside the Community that does not carry out economic activities in the Czech Republic, or otherwise if such performance is directly related to export of goods.

Articles 72(2) and (3) contain more specific principles in respect of deductible amount.

If the taxpayer uses the incoming supplies to effect only exempt financial supplies without the right to deduction, the input VAT cannot be recovered.

If the taxpayer uses the incoming supplies for both taxable supplies and exemptions without the right to deduction the entitlement to recover the input VAT has to be determined by a coefficient. Pursuant to Article 76 the coefficient shall be calculated as a proportion where the numerator is the sum of all the supplies subject to VAT excluded the VAT itself (i.e. all supplies with the entitlement to VAT deduction included all the exemptions with the right to deduction) and the denominator is equals the total of the sums in the numerator and the sum of rendered exempt supplies without the right to deduction. However, in the denominator must be excluded the following supplies, even if are exemptions with the right to deduction:

- the sale of fixed tangible and intangible assets used by a taxable person for his business activities;
- exempt financial activities if they represent occasional or accessory activities;

- the exempt transfer or lease of land, buildings, flats and business premises if they represent occasional activities.

If the numerator of the coefficient is zero (nil) or negative, the coefficient shall be regarded as being equal to zero.

The Czech VAT Law does not differentiate between received taxable supplies which are used both for taxable supplies and exempt supplies in ratios of e.g. 50:50 or 99:1. All such received taxable supplies reduce the relevant input VAT through the ratio.

If the coefficient is higher than 0.95, the final input VAT deduction is full. There is no minimum limit of coefficient allowing partial VAT recovery.

8.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

As regards the right to deduct input VAT in the banking sector, no official administrative guidance was issued.

In this respect, both Ministry of Finance and representatives of private sector were contacted, but apparently no concessions or particular practices were developed in this respect.

The Czech Republic has, neither in the legislation nor in practice, adopt any of the possibilities laid down in Article 17(5) a) to d) of the Sixth Directive.

This means that the deductible proportion with respect to goods and services used both for transactions where input VAT is deductible and for transactions where input VAT is non-deductible is determined strictly by means of the pro rata calculation as stipulated by Article 19(1).

8.3 Actual rate of deduction of input VAT in the financial sector

In respect of statistical information as regards the rate of input VAT recovery for banking sector it is not available neither at the Ministry of Finance nor in the private sector.

Apparently, collection of such information was not commissioned.

Based on the experience of private sector, the pro rata recovery for banking institutions is insignificant: 1% to 2%.

Due to its insignificance, some banks treat the whole amount of input VAT as non-deductible since the cost of implementation of a system of attribution of purchased goods and services to individual groups of supplies would override the benefit of claiming a portion of input VAT.

9 DENMARK

9.1 Legal provisions relating to deduction of input VAT

9.1.1 General overview of exemptions according to the domestic law

With effect from 1 July 1994, the Act 966 of 14 October 2005 (VAT Act: *Momsloven*, the “**Danish VAT Act**”) came into force³⁶. The Danish VAT Act contains a number of regulations, which until 1994 were laid down by orders (*bekendtgørelser*) issued by the Minister of Taxation according to the VAT Act. Also, a number of regulations from 20 different VAT orders are now contained in one order (Order 663 of 16 June 2006 concerning the VAT Act - the Joint VAT Order).

The Danish VAT Act is generally in line with the Sixth Directive.

Sec. 13 and Sec. 34 of the Danish VAT Act provide, as the Sixth Directive, for exemptions without right to deduction and exemptions with right to deduction, respectively. In general, *inter alia*, financial and insurance transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to recovery of input VAT is provided if the recipient is established outside the European Community.

Sec. 13 (1)(11) of the VAT Act lists the exempt financial activities and services connected therewith and Sec. 13(1)(10) VAT Act lists the exempt insurance and re-insurance activities and services transactions from VAT. The provisions correspond to Article 13(b) and (d) Sixth Directive.

For an exhaustive list of the insurance and financial services exempt see Denmark

With regard to the financial services there is no possibility to opt for registration as far as financial services are concerned.

9.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

According to the Danish Guidance Note on the VAT Act, Sec. 38 of the Danish VAT Act corresponds with Article 17(5)(a) and (b) of the Sixth Directive³⁷. If goods or services are used for taxable transactions as well as for exempt transactions, the input VAT on purchases, acquisitions, importation, etc. which are not connected solely with taxable transactions in goods or services must be separated by the entrepreneur and may be included in the amount of the VAT deductible on a pro rata basis according to Sec. 38(1) of the Danish VAT Act. In such cases the allocation of the credit is based only on the ratio between the taxable (including zero-rated) transactions and total value of the transaction within the tax period. An estimated preliminary ratio (last year's ratio) may be used provided that a final computation is made at the end of the year in order to adjust properly the amount of input VAT that is deductible.

It is possible to round up the pro rata deduction percentage, e.g. from 0.4% to 1% or from 21.3% to 22%³⁸.

If goods or services are used for taxable transactions and private transactions or transactions where input VAT is not deductible such as entertainment expenses and gifts the allocation of the credit is based on an estimate, usually the same estimate that is applicable regarding personal taxation³⁹.

The deduction, which an entrepreneur may claim during the tax period, is the amount of VAT invoiced to him. It should be noted that no deduction is allowed for payments in advance made before receipt of the invoice, although the supplier must account for the VAT included in advance payments at the time of receipt of the payment.

³⁶ Most recently amended by Law 1416 of 21 December 2005.

³⁷ Guidance Note on the Value Added Tax Law, J.2.1 Delvis Fradragsret § 38.

³⁸ Sec. 16, Order 1152 of 12 December 2003 concerning the VAT Act - the Joint VAT Order.

³⁹ Sec. 38(2) VAT Act.

When an entrepreneur is engaged in a mixed transaction, which includes both taxable (including zero-rated) transactions and non-taxable (i.e. exempt) transactions, a division is necessary⁴⁰.

The Danish VAT Act does not contain a specific rule corresponding to Article 19 (1) under the Sixth Directive, but the Guidance Note on the Value Added Tax Law refers to Article 19(1) of the Sixth Directive stating that it is possible to round up the pro rata computed in accordance with Article 19(1) Sixth Directive. Furthermore, it can be mentioned that there is no current case law, but that a case pro rata is ongoing. No judgment has been delivered to this date.

9.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

As from 1 January 2004, the amount of deductible input VAT is computed in accordance with Sec. 38(1) of the Danish VAT Act. The Danish Tax Authorities Administrative Notice of 24 November 2004 provides further clarification on the computation of input VAT on mixed transactions with regard to banking services⁴¹. Notice of 24 November 2004 implies that Denmark accepts the financial institutions gross margin for deduction purposes. A similar Notice applicable to institutions engaged in insurance activities does not exist.

According to the Administrative notice, financial services rendered by banking institution registered for VAT, shall be separated by dividing services attributable to business activities subject to VAT, and therefore liable to input VAT, and services attributable to VAT exempt activities.

Furthermore, pursuant to Sec. 38(3) of the Danish VAT Act., financial institution shall deduct input VAT on goods and services used for both taxable and exempt transactions separately for each sector if the authorities have authorized or compelled the banking institution to determine a proportion for each sector of its business. However, if the financial institution have not been either authorized or compelled to divide its business into sectors for VAT purposes then it is the taxable turnover of the (whole) business relative to the total turnover of the (whole) business which determines the pro rata (i.e. in accordance with the general rule). Therefore, input VAT on goods and services used for both taxable and exempt transactions is deductible on a pro rata basis.

The proportion deductible shall be made up by a fraction, having as the numerator the total amount of turnover (including zero-rated transactions⁴²) per year attributable to transactions in respect of which value added tax is deductible and as the denominator the total turnover. As stated above, the pro rata deduction percentage shall be rounded up.

According to Notice of 24 November 2004, the total turnover of the institution includes the turnover from VAT taxable business activities and the turnover from business activities not registered for VAT purposes.

Computation example on recovery rate of input VAT.

Turnover from separate taxable service transactions	DKK 500.000
Turnover (zero-rated transactions) ⁴³	DKK 100.000
Turnover from exempt transactions	DKK 400.000
Total Turnover	DKK 1.000.000

$$\frac{(500.000+100.000) \times 100}{1.000.00} = 60\%$$

⁴⁰ Sec. 40 of the Joint VAT Order.

⁴¹ Meddelse SKM 2004.464.TSS of 24 November 2004, Retningslinier for beregning af pengeinstitutters delvise fradragssprocent efter momslovens § 38, stk. 1.

⁴² Sec. 34 VAT Act.

⁴³ Sec. 34 VAT Act, (exports, delivery of goods to other EU-countries)

9.3 Actual rate of deduction of input VAT in the financial sector

There is no official statistical information with regard to the rate of input VAT recovery in Denmark. Generally, the recovery rate is low since financial services and insurance transactions are exempt. Accordingly, the rate varies depending on if the financial or insurance services transactions are taxable or exempt.

However, based on our investigation the average actual pro rata should be around 3%.

10 ESTONIA

10.1 Legal provisions relating to deduction of input VAT

10.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Article 16 of *Käibemaksuseadus* (Value Added Tax Act) dated 10 December 2003 (the “**Estonian VAT Act**”). In particular exemptions with regard to financial and insurance services are provided in Article 16(2) 1), 5) and 6) of the said Estonian VAT Act (see Estonia).

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, financial and insurance transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT.

It is worth noting that, the taxpayers are allowed to opt for taxation when certain conditions are met. This does not apply to insurance services.

10.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Article 29(1) of the Act provides, in line with the Sixth Directive, the general rule that taxable persons can deduct input VAT relating to goods and services used for the purposes of carrying out taxed supplies.

Article 32(1) provides that if a taxable person uses goods and services for the purposes of both taxable and exempt supplies (mixed transactions), the input VAT shall be deducted partially. Partial deduction shall be based on the proportion of the turnover the taxable person has generated from transactions where the input VAT can be deducted pursuant to Art 29(1) above, to the total turnover (proportion of taxable turnover to total turnover). The proportion is calculated as a ratio with:

- **numerator**, all turnover subject to VAT (including the exemptions with the right to deduction)
- **denominator**.

The result shall be rounded up to two decimal points or to a full percentage.

Article 33(1) provides for the methods of deducting input VAT in the case of mixed transactions.

The two allowable methods are either (a) the proportional deduction method (i.e. the pro rata) or (b) the combined method of actual use and proportional deduction method. Only one of these methods can be used during one calendar year. The pro rata method can pursuant to Article 33(2) be only applied to deduction of ALL input VAT.

According to Article 33(3) in applying the combined actual use and pro rata method the input VAT related to goods and services used solely for carrying out taxable transactions is deducted.

Input VAT related to goods and services used only for the purpose of tax exempt transactions are not deducted. Input VAT related to goods and services used for purposes of both taxable and tax exempt transactions are deducted using the pro rata method.

If the taxpayer applies the combined method of actual use and proportional deduction method he is required to keep separate accounting record.

Art 33(4) provides that when a taxable person makes in one sector only tax exempt or taxable transactions and in another sector mixed transactions, he may, with the written permission of the head of the tax authority, deduct in that sector the input VAT relating to goods and services received for the purposes of mixed transactions according to the pro rata method. Separate accounting is again compulsory.

According to Article 32(3) the taxable person may during a calendar year change the applicable proportion of taxable turnover to total turnover with the written permission of the

head of the tax authority if the actual proportion of taxable turnover to total turnover in the current calendar year is substantially different.

According to Art 33(2) the input VAT deduction must be based on the data relating to the previous calendar year. Provisional deductions made in the course of the year must be adjusted on the basis of data relating to the entire year through the VAT return of the last tax period of the year. If the business activities have been carried out for less than a year the proportion is fixed by the head of the tax authority based on the estimated proportion.

Article 32(2) of the VAT Act provides that the disposal of fixed assets is not treated as a transaction for the purposes of the pro rata. According to the same provision the services specified in Article 16 (2) 5) and 6) (financial services), in so far as these are incidental transactions, shall also not be taken into account.

Article 32(4), (4¹) and (4²) of the VAT Act are not directly relevant in the context of the research assignment. These provisions provide for the rules relating to adjustments of the input VAT which has initially been deducted in respect of movable and immovable capital business assets. Those adjustments must be made in the five and ten years, respectively, following the year in which the assets were taken into use. The annual adjustments must be made at the end of each calendar year on the basis of the actual proportion in which the assets were used for the purposes of generating taxable turnover during the given year.

10.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no other rules or guidance concerning the deduction of input VAT in addition to the above provisions of the VAT Act. There are also no known concessional practices deviating from the law that the tax authorities would use with respect to financial services companies. This means that also the financial sector companies must follow exactly the same rules as any other companies. There are no specific rules related to the calculation of pro rata for financial sector companies.

No public clarifications have been provided on how to calculate the turnover of financial services for the purposes of applying the pro rata. It is possible that individual clarifications have been provided about the application of the rules to actual circumstances. However, these clarifications are not public.

10.3 Actual rate of deduction of input VAT in the financial sector

For all the credit institutions (banks) the proportion of the taxable turnover to total turnover in 2005 was 1.5%. As this ratio should be taken as the basis to make the deduction it is fair to conclude that after rounding up the figures the actual pro rata recovery rate for banks was 2%. For the 9 first months of 2006 the proportion is 5.5%.

For insurance and pension funds the ratio in 2005 was 2.7%. Based on this figure the pro rata would have been 3%. For the 9 first months of 2006 the proportion is 10%.

The figures for 2006 do not reflect the annual adjustments that will be made at the end of the year.

In these cases the taxable turnover includes transactions taxed at the standard rate, reduced rate and zero rated transactions. It doesn't, however, include financial services rendered to clients established outside the European Community that would be necessary to be taken into account when calculating pro rata. In addition, the total turnover includes the disposal of fixed assets which should be excluded for the purposes of calculating pro rata. Therefore the above ratios are not completely accurate.

11 FINLAND

11.1 Legal provisions relating to deduction of input VAT

11.1.1 General overview of exemptions according to the domestic law

Finland introduced its VAT legislation just before it became an EU Member State in 1995. The VAT came into force from 1 June 1994 (the “**Finnish VAT Act**”). The earlier turnover tax system related only to sale and hiring of goods (incl. such energy products as gas and electricity) and to some work services relating to goods (like repairing of goods). All other services rendered were outside of the scope of the earlier turnover taxation.

Currently, in line with the Sixth Directive, a distinguish is made between exemptions without the right to deduct the input VAT and exemption with the right to deduction the VAT⁴⁴. Among the former, are included financial and insurance transactions.

However, certain exempt services, which do not entitle the entrepreneur to a deduction if supplied within the Community, do carry a right to VAT recovery if supplied to persons established outside the Community.

11.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Already during the abolished turnover taxation the question of input tax deduction right for goods used in mixed purposes existed. The input tax had to be divided to deductible and to non deductible parts. One of the main questions was the right to deduct the input tax of the electricity and warming. The appeal court regarded for example that hotel- restaurants were able to deduct a greater part of the electricity because the use was larger in restaurants than the use for accommodation services. During the turnover taxation there was also a special legal rule, that if the input turnover tax related less than 10% to taxable purposes no deduction was allowed and on the other hand if the use for taxable purposes exceeded 90% of the whole use a full deduction was allowed.

When the present VAT law came into force the question of input VAT in mixed businesses was regulated in the Article 117 of the Finnish VAT Act: “*The input VAT of goods and services which a taxable person has acquired or (later) taken to only partly deductible purposes can be deducted only for the amount which equals the amount of use for taxable purposes*”. The VAT act does no anymore include the 10% and 90% regulations mentioned above during the earlier turnover taxation.

The pro rata mechanism mentioned in the Article 19 of the Sixth Directive has not been implemented in the Finnish VAT legislation. It is the taxable persons’ right and obligation to allocate correctly the input tax deductions according to the general principle of the above mentioned Article 117 of the VAT Act. Estimations are in practice accepted by the VAT authorities if exact measures are not available. However, the estimation methods must be shown to the tax authorities when demanded and be acceptable.

11.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no other rules or guidance concerning the deduction of input VAT in addition to the above provisions of the VAT Act. There are also no known concessional practices deviating from the law that the tax authorities would use with respect to financial services companies. This means that also the financial sector companies must follow exactly the same rules as any other companies. There are no specific rules related to the calculation of pro rata for financial sector companies.

11.3 Actual rate of deduction of input VAT in the financial sector

Statistical numbers of pro rata recoveries for financial services companies in general are neither available nor studied. However, VAT inspectors do compare the information they get

⁴⁴ In Finland, the zero rate is generally applied as a technical rate to enable supplies of goods and services which are exported or intra-Community supplied, or to some special supplies of goods.

Survey on the recovery of input VAT in the financial sector
December 2006

during the VAT inspections within financial services companies. This information is not public because tax information of individual taxable persons are secret by law.

12 FRANCE

12.1 Legal provisions relating to deduction of input VAT

12.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Articles from Articles 261 to 263 Subsec. III, Sec I and 271 Subsec. II, Sec. IV of in the French Tax Code *Code Général des Impôts* (CGI) (the “CGI”). In particular exemptions with regard to financial and insurance services are provided in Article 261C of the CGI (see France).

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, financial and insurance transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

It is worth noting that, the taxpayers are, however, allowed to opt for taxation.

12.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

In general, input VAT is deductible in full when the taxpayer carried out taxable operations, always taxable under the law, or taxable under the option provided under Article 260 B CGI.

Article 260 B CGI, as amended by the Finance Amendment Law for 2004, provides an option for banks and other financial institutions to be subject to VAT with respect to a number of exempt transactions. This option may also be exercised by persons the main business of which is to carry on financial or banking transactions, but not by persons carrying on financial or banking transactions as an incidental activity (Doc. Adm. 3 L 5132 Nos. 5-13). Indeed, Article 260 C CGI provides a negative list of operations for which the exercise of the option is prohibited, so that such operations remain in any case exempt.

Amongst others, the “negative list” includes the following operations:

- operations carried out between entities that are part of the *Chambre syndicale des banques populaires*;
- operations carried out between *caisses de crédit mutuel* that are members of the *Confédération nationale du crédit mutuel*;
- interest of loans and assimilated revenues included loan of shares;
- sale of securities and negotiable debt instruments;
- commissions received on emissions and placements of shares;
- payments of the Treasury to the French National Bank;
- amounts received (e.g. commission fees) in connection with the issuance of shares of certain investment companies (SICAVs) and investment funds which have specialized in investment in debts;
- certain banking operations in relation to the financing of intra-Community supplies or export transactions or operations outside France as determined by the Minister for the Budget; however, the option may apply to commission fees in respect of such transactions subject to certain conditions;
- operations which are subject to the insurance tax; and
- transactions on gold and currencies.

The said list is not limitative. Reference is made to an old tax (TAF i.e. *taxe sur les activités financiers*). This is due to the fact that when the said TAF has been removed from the CGI it has been ruled that are VAT exempt but subject to VAT upon election, financial services that were effectively subject to the TAF before January,1, 1979 i.e. transactions that were not TAF exempt. That the reason why if the financial products is not listed in the CGI we must check in the old legislation if the same revenues was or not TAF exempt. The old legislation is surviving just for this purpose.

Whereas prior to 1 January 2005, the option was irrevocable, such option is now revocable after a 5-year period, provided that the entity has not benefited from a VAT refund within the 5-year period concerned⁴⁵.

If taxable persons carry out mixed transaction (*redevables partiels*) (i.e. taxable transactions and VAT exempt transactions) the direct allocation method and/or the pro rata method, for the computation of the deductible input VAT, are provided.

In primis, a distinction is made between (i) fixed assets to which the pro rata method is used in a mandatory manner and (ii) for goods, other than fixed assets, and services to which the direct allocation method applies in principle. Indeed, in the latter case, as a derogation to the compulsory direct allocation method the taxpayers may, upon request, be allowed by the French tax administration to apply the pro rata method to all goods, other than fixed assets, and services (Annex II, Article 220 CGI). The administrative authorization applies for one civil year and is renewed each year tacitly, unless a termination notice is sent by the taxpayer before 31 December of the year in question.

The hierarchy is about to change since the direct allocation method will become mandatory for all goods and services including fixed assets to comply with the VAT principles as interpreted by our high court years ago. From a practical standpoint the tax authorities were not in a position to impose the pro rata method to fixed assets fully allocated to a taxable business and did not ignore that they were wrong but nevertheless they have just agreed to change both their doctrine and the law.

The direct allocation method, defined under Article 271(V) and (VI) of the CGI and Annex II, Article 219 of the CGI, means that:

- a full deduction is available if the goods and/or services are exclusively used for transactions which entitle the taxable person to a deduction;
- no deduction is available if the goods and/or services are exclusively used for transactions which do not entitle the taxable person to a deduct; and
- a partial deduction is available if the goods and/or services are used for transactions which partially entitle the taxable person to a deduction (mixed purpose). In the latter case, the pro rata method is used.

The ratio of the pro rata must be determined as follows:

- for the **numerator**: the annual turnover pertaining to operations that give rise to deduction of input VAT, and including subsidies directly linked to the price of these operations; and
- for the **denominator**: the annual turnover pertaining to operations included in the numerator and to operations that do not give rise to the deduction of input VAT (exempt transactions), as well as the all subsidies (even those that are not directly linked to the price of the operations).

It is worth noting that, amongst others, (i) sale of investment assets whether such sales are subject to VAT or not and (ii) the self-supply of fixed assets subject to VAT are excluded from the calculation of the pro rata (Doc. Adm. 3 D 1711 No. 12).

For the determination of the pro rata in each year, the taxpayer may use the turnover of the preceding year, or estimate the turnover of the current year if the taxpayer is a newly created enterprise⁴⁶. Any difference between the provisional and definitive calculation leads to payment of additional VAT to the tax authorities or to a refund from the tax authorities.

Generally, taxable persons that carry on activities in different sectors, are allowed to separately compute the input VAT for each sector provided the fixed assets are used exclusively for one of the sector (Annex II, Article 213 CGI).

⁴⁵ Detailed rules are provided in Guideline 3 L-3-05 of 3 August 2005. Some transitory rules apply, but will not be discussed in this survey.

⁴⁶ Annex II, Art. 214 CGI

According to the administrative doctrine⁴⁷, VAT sectorization is generally not available to banks and financial institutions. The general rule that applies to the banking and financial industry is that of the pro rata. However, an exception applies in respect of lease operations (for movable or immovable property) that may constitute a distinct sector for VAT purposes.

12.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

Rules related to the deduction of input VAT in the financial sector in France, and in particular, rules concerning the computation of the pro rata of input VAT may be found in few Guidelines⁴⁸ and administrative documentations⁴⁹ issued by the tax administration and some case law from the Administrative Supreme Court.

The annual turnover of derivative financial instruments is taken into in the pro rata of input VAT of banks and financial institutions. Guideline 3 L-1-06 of 17 January 2006⁵⁰ on derivative financial instruments provides two alternative methods for computing the annual turnover of derivative financial instruments. The Guideline applies to banks and financial institutions for the determination in 2007 of the definitive deduction percentage of 2006.

Operations on derivative financial instruments are exempt from VAT without option for taxation. In addition, profits arising from the delivery of underlying assets (shares, bonds) are exempt at the termination of the contract.

The Guideline distinguishes between three categories of financial instruments:

- (i) swaps (*contrat d'échange*), such as interest rate swaps, currency swaps;
- (ii) financial futures (*instruments financiers à terme ferme*); such as, Forward Rate Agreement (FRA), caps floors and collars; and
- (iii) optional financial futures (*instruments financiers à terme optionnels*) such as swap option and warrants.

For each category, the turnover to take into account for the computation of the pro rata, as defined under Annex II, Article 212 CGI is determined by application of one of the two following methods.

Under the first method (*somme des flux nets positifs dégagés au titre de chaque contrat d'ITF au cours de l'année civile*), the annual turnover is computed on the basis of the sum of financial net flows on each contract during a year. The sum of financial net flows is the positive difference between the financial flows received, and the financial flows paid. Losses are excluded from the pro rata. The accumulation of net positive flows determined per contract constitutes the annual turnover to add to the denominator of the ratio.

Under the second method (*Résultat positif dégagé sur l'ensemble des contrat d'IFT*), the annual turnover must relate to all the contracts and has to be put on the denominator of the ratio of input VAT deduction. It is computed by the sum, for each category of contracts, of (i) the net positive result arising from contracts concluded with persons that are resident or established outside the EU (zero-rated transactions) and (ii) the net positive result arising from contracts concluded with persons established within the EU (exempt transactions). Each of these net positive results amount to the sum of financial flows paid and the financial flows received in one year. Losses are excluded for the pro rata, and may not be carried forward to the next year.

With respect to operations, including negotiations, on currencies, bank notes and coins, the turnover to take into account for the computation of the pro rata includes, commission, discounts, profits⁵¹ (gross profit) and other remunerations⁵². The gross profit, which is defined as the difference between the gross acquisition price, and the gross selling price, on gold

⁴⁷ DB 3L551/H

⁴⁸ Guideline 3 L-6-01 of 30 July 1991, 3 L-6-02 of 21 April 1992 and 3 L-1-06 of 17 January 2006.

⁴⁹ DB 3-L 55 of 10 May 1996

⁵⁰ Guideline 3 L-1-06 of 17 January 2006 repealed Guideline 3 L -2-09 of 9 August 2004 on swaps.

⁵¹ « Profits » means the difference between the entry value of the currency (i.e. acquisition value for accounting purposes) and the output value (i.e. value entered for accounting purposes as sales value).

⁵² Guidelines 3 L-6-01 of 30 July 1991 and 3 L-6-02 of 21 April 1992

transactions, other than for industrial use, must be taken into account for the computation of the pro rata⁵³.

Dividend received from banks and financial institutions do not fall within the scope of VAT, and may not be included in the denominator of the ratio⁵⁴.

In respect of cashless (scriptural) currency exchange operations, an exemption without option was introduced by Law of 26 July 1991, so that profits arising from cashless currency exchange operations may no longer be added to the numerator of the pro rata. However, the portion of profits related to such operations rendered to persons domiciled or established outside the EU may be added to the numerator of the pro rata. The tax administration admitted⁵⁵ a fixed determination for these operations. For cashless currency exchange operations related to export, the fixed determination amounts to 40% of the total operations related to the export and to deliveries exempt under Article 262 ter-I CGI. For other cashless operations rendered to persons resident or domiciled outside the EU, the portion of operations that give right to deduction of input VAT amounts to 32%⁵⁶.

Exchange of currency at the counter, which are treated as financial services, give rise to a deduction of input VAT when such services are rendered to persons resident and established outside the EU. The fixed rate of deduction is set at 30%⁵⁷.

Operations realized on the MATIF and the MONEP

The MATIF⁵⁸ and the MONEP are managed by Euronext. For operations realized on the Matif and the Monep, the profit to take into account for the denominator of the ratio used to calculate the pro rata of deduction of input VAT amounts to the sum of annual gains and annual losses on both markets at the termination of the contracts. Losses are carried forward against net result arising in the next year⁵⁹.

Case law

Interest on loans granted by the head office of a bank located in France to its branches located outside the EU do not fall within the scope of VAT and are not taken into taken in the computation of the pro rata of the head office⁶⁰. The same rule applies to interest received by the French branch from a head office located outside the EU⁶¹.

Under French case law⁶², the turnover derived from the granting of credit, including interest interventions, is the amount received by the bank under the heading interest, commission, etc. Those amounts must not be reduced by the interest paid by the bank for the purposes of acquiring the financial means necessary to grant the credit.

According to an advise from the Administrative Supreme Court⁶³ (*Conseil d'Etat*), currency exchange are supplies of service the remuneration of which is constituted by the commission received and the realized exchange profit. Accordingly, the taxable amount of currency exchange is the remuneration received minus the interest paid, so effectively using the gross margin.

It should be noted that despite the existence of various tax doctrines that allow to define the turnover as the "profit", the tax authorities refuse to consider the profit as the turnover for all the financial services that are not remunerated by a commission. It means that in the absence of a specific ruling, the bank is supposed to take into account the gross amount of the

⁵³ Guideline 3 L-6-02 of 21 April 1992.

⁵⁴ DB 3 L-552, No 39 and 40 of 10 May 1996.

⁵⁵ DB 3 L-55, No 5 of 10 May 1996.

⁵⁶ For the determination of the fixed rate of 32%, see DB 3-L 55 No 5 of 10 May 1996.

⁵⁷ DB 3L55, No 6 of 10 May 1996

⁵⁸ *Marché à terme d'instruments financiers (MATIF)*

⁵⁹ Guideline 3 L-6-87 of 10 November 1987, DB. 3 L-551 No 13 of 10 May 1996.

⁶⁰ CE, 29 June 2001, No 176105, SA Sudaméris, RJF 10/01 No 1217.

⁶¹ Rép, Guéna : AN 23 November 1987 p. 6423 No 29039.

⁶² CE, 16 September 1998, No 1777005, CR-CAM de la Côte-d'Or : RJF 11/98 Mo 1286. This case upheld an earlier decision of the Court of Appeal of Nantes of 9 November 1995 (CAA Nantes, 9 November 1995, No 93-795).

⁶³ Advise CE 26 February 1993, No 143039 sect., Caisse régionale du crédit agricole mutuel de Savoie, published in the Official Journal of 23 March 1993, p.4512; BO 3 L-2-93.

turnover (there are currently discussion concerning revenues in relation to the loan of shares for example). So the “netting” as also called by the banking sector is not a general rule.

Netting applies notably to transactions on shares that are not fixed assets carried out by a bank (BOI L-3-89), revenues in relation to the assignment of receivables to specific vehicle (BOI 5 I-3-89), revenues in relation to transactions on currencies or on gold (Article 256 IV 2°).

Netting is refused in any case for businesses that are not bank as the various rulings only concern services supplied by banks and financial services providers (by reference to the non VAT legislation).

12.3 Actual rate of deduction of input VAT in the financial sector

Statistical numbers of pro rata recoveries for financial services companies in general are neither available nor studied.

13 GERMANY

13.1 Legal provisions relating to deduction of input VAT

13.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Article 4 of the German VAT Act. In particular exemptions with regard to financial and insurance services are provided in Article 4 number 8(a)-(h) of the said German Vat Act (*Umsatzsteuergesetz - UStG*) (the “**German VAT Act**”) (see Germany).

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

Germany has used the right of Article 13(C)(b) of the Sixth Directive to grant an option for taxation with regard to certain financial services. According to Article 9(1) of the VAT Act, taxable persons can opt for taxation with regard to such services under the condition that the service is rendered to another taxable person for purposes of his business. The favoured financial services are mentioned in Article 4 number 8(a)-(g) of the VAT Act. These are almost all important financial services, such as granting loans and credit, transactions concerning payments, etc. They also include transactions in shares and interests in companies.

13.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Various procedures may be applied to taxable persons engaged in both taxable and exempt transactions, such as financial institutions, for the purpose of attributing input tax to those categories of transactions. While the Sixth Directive favours the application of a general pro rata (Articles 17(5) and 19(1) of the Sixth Directive), Germany made use of the concessions embodied in Article 17(5) of the Sixth Directive, which authorize the Member States to compel businesses to apply different pro rata fractions to separate divisions of their business.

Thereby, Germany follows the method of direct attribution according to economic use in accordance with Article 17(5)(c) of the Sixth Directive compelling taxable persons to make the deduction on the basis of the use of all or part of the goods and services.

Article 15 of German VAT Act deals with the deduction of input VAT.

In principle, an entrepreneur may deduct this input VAT if the goods and services have been received for business purposes and relate to taxable supplies (Article 15(1) sentence 1 German VAT Act). Goods which are used in the business for less than 10% are not considered to be received for business purposes (Sec. 15(1) sentence 2 German VAT Act). Article 15(2) German VAT Act states that VAT incurred on the purchase, acquisition or import of goods and services, which directly relate to:

- exempt activities; or
- activities performed outside Germany that would have been exempt when performed in Germany

cannot be recovered. However, Article 15(3) German VAT Act provides that, in so far as entrepreneurs use the goods and services for the purpose of carrying out exempt transactions, input VAT remains deductible if it relates to supplies referred to in Article 4 number 8(a)-(g) German VAT Act (exemption for financial services), provided that:

- the customers are resident or established outside the Community; or
- those services are directly related to goods destined to be exported to a place outside the Community.

Moreover, as mentioned above, Germany grants an option for taxation with regard to certain financial services.

Article 15 (4) of German VAT Act deals with VAT deductions in respect of goods and services used for mixed purposes. Accordingly, if an entrepreneur makes both exempt and taxable transactions, the deductible input VAT is first determined by attributing it to the turnover to which it economically belongs (i.e. direct attribution). If the expenses which are charged with input VAT are not directly attributable to exempt or taxable turnover (e.g. VAT on general overhead), the proportion of deductible input VAT must be "reasonably estimated" (Article 15(4)2 German VAT Act). Article 15(4)3 German VAT Act points out that only in case input VAT cannot be economically attributed, the deductible input VAT may, within the concept of the direct allocation method (and not based on Article 19 of the Sixth Directive), be determined in relation to the turnover derived from taxed transactions to total turnover.

Remark 208 of the VAT administrative rules provides detailed rules on how to calculate the deductible input VAT in accordance with Article 15(4) of the German VAT Act. Accordingly, the total amount of input VAT has to be allocated to three different groups:

- fully deductible input VAT in respect of goods and services exclusively used for the purpose of carrying out taxable transactions;
- non-deductible input VAT in respect of services and goods exclusively used for the purpose of carrying out exempt services; and
- input VAT in respect of services and goods used for mixed purposes.

The allocation has to be done on the basis of economic attribution. Company cost and financial accounting statements should be used as indicators. The input VAT deduction must be based on data relating to the tax period during which the tax is charged to the entrepreneur or the tax has become chargeable. In respect of immovable property, the input VAT is generally allocated according to the actual use.

The reasonable estimation under Article 15(4)2 German VAT Act, has to be carried out on an individual basis and in terms of economic attribution following a systematic approach. The application of a simple ratio of turnover derived from taxed transactions and total turnover is not considered as a method of reasonable estimation. Only if an allocation based on economic attribution is not appropriate, the deductible input VAT within the concept of direct allocation method (and not based on Article 19 of the Sixth Directive) may be determined in relation to the turnover derived from taxed transactions to total turnover. Turnover derived from intra-Community acquisitions and imports are not to be included here.

Consequently, unlike the order of precedence of methods in the Sixth Directive, under Article 15(4)3 of the German VAT Act and remark 208 VAT administrative rules the direct use method takes precedence over the pro rata method, which is the ratio applied in Germany within the concept of direct allocation method as the final reasonable estimation.

13.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

Until 1991, remark 208(4) of the VAT administrative rules allowed banks and other financial institutions to use a pro rata deduction of input VAT in respect of goods and services used for mixed purposes. This pro rata known as "bank key" (*Bankenschlüssel*) has been abolished and not been reintroduced since. The financial authorities did also not provide any official follow-up regulation. Therefore, only the general rules of Article 15(4) of the German VAT Act and remarks 207-210 VAT administrative rules are applicable for the apportionment of deductible input VAT.

In 1994 the financial administration of Frankfurt provided internal administrative guidelines for the interpretation of the general rules concerning the calculation of deductible input VAT for the financial sector. The principles of the guidelines became the official code of conduct for tax audits of the fiscal authorities and are still applicable. Accordingly the apportionment of input VAT should be based on an appropriate estimation based on in-house business aspects rather than transaction turnovers. Therefore, at first, the total amount of input VAT has to be apportioned horizontally among the different segments of the corporation, such as the parent company, PE's or groups. In a second step, the turnover of each segment is classified vertically, where turnover derived from goods and services in respect of which VAT is not deductible, is excluded. In a third step, the deductible input VAT of each company segment is

calculated, if the input VAT can be allocated directly to turnover derived from taxable transactions. Finally, as far as the paid input VAT is linked to mixed transactions, the deductible input VAT is determined by allocating it to the turnover to which it is economically attributable. For determining this relation, the relative impact of employee activities has to be taken as an indicator.

However, in order to serve the special needs of financial institutions, the tax authorities developed a new method for an appropriate estimation under Article 15(4)2 of the German VAT Act, which can be applied alternatively. The "new bank key" is based on a margin-model. On 12 April 2005, the Federal Ministry of Finance introduced the new method to the banking associations by an official letter, which has not been disclosed to the public. Starting point for the determination of the deductible part of input VAT is again the apportionment of the input VAT into three groups as mentioned in remark 208 VAT administrative rules, i.e. with regard to the remainder of input VAT, which is not directly attributable to taxable or non-taxable transactions, the proportion of deductible input VAT must be reasonably estimated. Under the "new bank key", the reasonable estimation under Article 15(4)2 of the German VAT Act may be carried out by applying an apportionment model based on margins:

- the margin of credit transactions is calculated by deducting the refinancing costs of the bank for the purpose of acquiring the financial means necessary to grant the credit from the amount of interest received by the bank;
- the margin of transactions in shares on behalf of a third party consists of the commission received by the bank. For those transactions that form part of the bank's own portfolio a fictitious commission similar to commissions paid by third parties shall be taken into account;
- the margin of other transactions, i.e. currency transactions or transactions with derivatives, must be determined on the basis of the amount charged to the bank's customers.

The deductible input VAT can be computed in two different ways. As far as input VAT can be allocated to the different groups of transactions, a percentage can be calculated for each division. Otherwise the deductible input VAT is calculated by using the following general formula:

- **Numerator:** The total amount in respect of which VAT is deductible (margins)

- **Denominator:** The total amount attributable to transactions included in the numerator (margins) and to transactions in respect of which VAT is not deductible.

In the latter case, specific circumstances such as different volumes of credit transactions adjusted for.

In respect of goods and services used for other transactions that are not typical for the banking sector, only the general rules of Article 15(4) VAT Act and remark 208 VAT administrative rules are applicable.

13.3 Actual rate of deduction of input VAT in the financial sector

There are no statistical numbers available with regard to the national average of input VAT recovery rates of companies operating in the financial sector. As Article 15(4)2 VAT Act allows to determine the proportion of deductible input VAT, which is not directly attributable to exempt or taxable turnover, by way of a reasonable estimation, the individual results are hardly comparable. The results are, *inter alia*, subject to the fiscal secret and therefore cannot be disclosed to the public.

However, based on our investigation the average proportion of deductibility in banking sector should be around 17%.

14 GREECE

14.1 Legal provisions relating to deduction of input VAT

14.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Articles from Law 2859 of 2000 (the “**Greek VAT Code**”). In particular exemptions with regard to financial and insurance services are provided in Article 22 of the Greek VAT Code (see Greece)

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to a recipient located outside the European Union or if they relate to export.

14.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Article 30(1) of the Greek VAT Code provides that the right to deduct is granted so long as the goods or services are used for the performance of transactions subject to tax. This definition is narrower than the letter of Article 17(2) of the Sixth Directive which refers to the purposes of taxable transactions. However, it reflects, in essence, the rule of the Sixth Directive and therefore input VAT may be deducted only if it is associated to output taxable transaction. As regards specifically the proportion (pro rata) of deductible input VAT in case of goods and services used for both taxable and non-taxable (mixed) purposes the following rules apply

Following the provisions of the Sixth Directive the proportion is determined as a fraction having as numerator the annual turnover, excluding VAT, attributable to transactions in respect of which VAT is deductible while as denominator the amount of the nominator and the transactions in respect of which VAT is not deductible.

In addition:

- a) subsidies are indeed included in the denominator with the exception of subsidies included in the taxable amount;
- b) the proportion as a percentage is rounded up to the next unit (76,02 % to 77 %);
- c) amounts of turnover attributable to capital goods, as well as, transactions of financial nature (Article 13B (d) of the Sixth Directive) to the extent that they are incidental are excluded from the calculation of pro rata. The original version of the Greek VAT law was making reference to *temporary* rather than *incidental* transaction but following decisions of the Greek Courts (Council of State 3728/2004) an amendment was enacted to bring it in line with the Sixth Directive;
- d) if the non-deductible VAT is up to 30 Euro annually then is treated as null;
- e) based on a prior ruling of the Director of the competent tax office the taxable person may be authorized or compelled to determine a proportion of each sector of his business provided that separate accounts are kept for each sector or to be authorized or compelled to make the deduction on the basis of the actual use of the goods or services provided that separate accounts are kept;
- f) deduction is made on a provisional proportion as results form the return of the previous year but it is subject to adjustment with the final return of the year in question.

14.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no special concessions or officially published administrative practices relating to deduction of input VAT in the financial sector in Greece. Therefore, the general rules are followed.

14.3 Actual rate of deduction of input VAT in the financial sector

There are no official statistical information as regards the rate of input VAT recovery in the financial sector. Generally, the recovery rate is low since financial services and insurance transactions are exempt. However, based on Greek Ministry of Finance estimations the actual pro rata should be from 0% to 3%.

15 HUNGARY

15.1 Legal provisions relating to deduction of input VAT

15.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Article 30 of Act LXXIV of 1992 on Value Added Tax (the “**Hungarian VAT Act**”) and Annex 2 to the VAT Act. In particular exemptions with regard to financial and insurance services are provided in point 6 of annex 2 of the VAT Act (see Hungary).

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

15.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Section 33 (1) of the Hungarian VAT Act states that the input VAT cannot be deducted in Hungary if the goods or services were directly used for a tax-exempt supply of goods or services (including financial services) or they were used for purposes other than the business activities. Therefore the Hungarian provisions are in accordance with the rules of the Sixth Directive.

Section 4/C of the Hungarian VAT Act specifies the rules of group taxation for a group of domestic companies and branches. The VAT group should include at least a financial institution or an investment company or an insurance company and another company which provides outsourced services to the other. If a group company provides services to another group member, those services will not be subject to VAT and the revenue from such services should be treated as if it was related to tax-exempt services.

Section 38 prescribes the rules for apportioning VAT. Under Paragraph (1) of the Section, taxpayers must keep separate records of deductible and non-deductible input VAT. Therefore, if the input VAT is directly related to a VAT-exempt transaction or a transaction whose purpose is other than the business activities subject to taxation, the input VAT is not deductible under any circumstances. Also, with respect to goods and services used exclusively for the purpose of carrying out other transactions, input VAT is fully deductible.

According to Section 38 (2), if the input VAT is related to both business and non-business activities, and the deductible input VAT cannot be determined definitely from the records, the taxpayer should determine a deduction rate. When applying the apportionment method, the taxpayer should choose the method which best reflects the actual use and is based on a natural unit of measurement (direct use method). If such an apportionment is not possible, the taxpayer may conclude an agreement with the competent Tax Authority on the applicable apportionment ratio.

If the taxpayer carries out both business activities which entitle it to deduct the input VAT, and business activities which do not entitle it to deduct the VAT, the taxpayer should divide the input VAT according to a pro rata apportionment specified in Appendix 3 of the Hungarian VAT Act. The rules set out in Appendix 3 are based on the former Hungarian practice and the interpretation of the Sixth VAT Directive, and therefore some of the rules are specific to Hungary.

The deduction ratio is defined as the consideration for supplies of goods and services which entitle the taxpayer to deduct the VAT incurred (including supplies of goods and services outside the Act’s territorial scope) divided by the total consideration for the supply of goods and services.

The numerator includes grants or state aid directly or indirectly related to the supplies of goods or services which entitle the taxpayer to deduct the VAT. The denominator also includes, in addition to the above grants and state subsidies, those that are related to the supplies of goods and services which do not entitle the taxpayer to deduct input VAT.

If financial services are provided to a taxpayer, who has a registered office or establishment outside the Community or if those services are directly related to goods exported to a place outside the Community, the consideration for those services increases both the denominator and the numerator.

Point 2 of Appendix 3 sets out a specific rule when it prescribes that the following transactions do not qualify for the purposes of the pro rata apportioning if they are only carried out occasionally:

- disposal of tangible assets,
- financial services and services auxiliary to financial services (excluding safe transactions and partial financial leasing),
- transfer of the rights of creditors and rights which represent ownership,
- assignment of rights and assumption of debt.

Another specific rule compared to the Sixth VAT Directive is that, if transfers of the rights of creditors and rights which represent ownership are not occasional events but are part of regular business operations, and the revenue from these services exceeds 10% of the business's total revenues, then the numerator should also be increased by the financial revenue (defined by the Accounting Act) related to these transactions.

In Hungary, the ratio must be rounded to two decimal places (i.e. for a percentage), although the VAT Act does not explicitly mention the exact method of rounding.

Under Point 4 of Appendix 3, taxpayers have the option of dividing the input VAT:

- cumulatively during the year by using the deduction ratio calculated by the carry-over method on the basis of the year's data; or
- in the tax periods during the year, the taxpayer may use the previous year's deduction ratio (temporary ratio). In this case, the taxpayer should define the ratio at the year-end and if the result differs from the temporary ratio, it should divide the aggregate VAT base according to that final ratio, and declare the difference in its tax return.

If the value of the consideration for a supply of goods or services subsequently changes materially (e.g. discounts, cancelled transactions, etc), the taxpayer should re-determine the deduction ratio and modify the deductible input VAT in its tax returns. The level of materiality should be defined in the taxpayer's Accounting policy in accordance with Hungary's Accounting Act. This difference should be declared in the last period of the tax year, or otherwise the taxpayer may file a self-revision, free of the self-revision fee, by 15th February.

The capital goods scheme covered by Part II of Appendix 3 is probably not directly relevant in the context of the research assignment. It sets out the rules relating to adjustments of the input VAT which was initially deducted in respect of tangible assets. Those adjustments must be made at the end of the next four or nine (in case of real estates) years respectively, following the year in which the assets were taken into use. The annual adjustments must be made at the end of each financial year on the basis of the rate of recovery of input VAT applicable to the past year, unless the proportion of activities using the goods that carry entitlement to VAT recovery to activities that do not carry such entitlement changes less than 10 percentage point. If the tangible assets are disposed of within 60 or 120 months of the date when they were taken into use, Section 39 (3) of the Hungarian VAT Act allows similarly an adjustment for the deduction of VAT in proportion to the remaining period.

15.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

As we described previously, the input VAT on goods and services used for the purpose of carrying out both taxed and exempt transactions is deductible in proportion to turnover derived from both categories of transactions. However, where immovable property is partly used for staff facilities (e.g. staff canteen) or any other purposes that are not deemed to be for its business purposes (i.e. the canteen is not leased), deduction in respect of use of the

property as a whole (cost of the property itself, and related expenses) *must* be based on the direct use.

In accordance with the Hungarian VAT Act, a company may exclude financial services and auxiliary services when determining the deduction ratio if those services are provided occasionally. The term "occasionally" has been defined by Hungarian practice. Tax Authority circular no. 1995/241 states that neither the frequency of the transaction nor the amount of the consideration is relevant, but the taxpayer should consider the business purpose of the company and whether the services are significant within its business activities. However, if the consideration for one transaction exceeds 15% of total revenue, the transaction may not be treated as occasional, according to Tax Authority circular no. 2003/51. Ruling 2003/51 also states that if the taxpayer has permission from the Hungarian Financial Supervisory Authority to carry out financial activities, these activities may not be treated as occasional. Tax Authority circular no. 2003/51 emphasizes this characteristic in relation to factoring activities.

As regards the pro rata deduction of input VAT, the following principles apply:

- a. **Turnover derived from the granting of credit**, including interest interventions, is the amount received by the bank under the heading: interest, commission, and other related fees;
- b. **Turnover derived from transactions in shares and bonds** on behalf of a third party consists of the commission received by the bank, increased by the difference between the selling and purchase prices of the shares, i.e. the bank's gross profit margin. The taxpayer should also take into account other financial revenues related to the transaction. Interest received on bonds that form part of the bank's own portfolio must not be included in the turnover. Dividends arising from shares in businesses in which the bank participates do not generally qualify as turnover for pro rata apportionment purposes.
- c. Where banks grant credit by means of renting out business assets under a **financial lease** contract, in view of the fact that, from the bank's perspective, the transaction consists of the granting of credit, only the interest included qualifies as tax exempt. Therefore the principal amount, but at least the purchase price (or production cost) - if the goods provided are subject to VAT - should be taken into consideration, both in the denominator and the numerator, when determining the deduction ratio. Insofar as the interest is not subject to VAT, the interest must be treated as turnover derived from exempt transactions. Where it is subject to VAT, the interest must be treated as turnover derived from taxed transactions.
- d. **Turnover derived from factoring** includes the difference between the purchase price and the nominal price of the receivable, the factoring fee, administration fee, the credit assessment fee, etc., in accordance with circular no. 2003/51. The follow up of payment does not come within the scope of the VAT Act.
- e. **Turnover derived from insurance activities** usually includes the insurance fee and other related fees.

Depending on the actual transaction, it should be examined whether other fees charged may qualify as related. If the fees qualify as related to the fee of the principal service, then in accordance with point 22. §(3) c) of the Hungarian VAT Act, they should not be charged based on their own statistical classification, but they share the VAT treatment of the principal activity's fee. Therefore, if the fees relate to tax exempt financial services, they are also tax-exempt.

Based on Tax Authority circular no. 1994/93, the fees are related to the activity if they are charged as the consideration for subsidiary activities. The activities are deemed subsidiary, if

- the subsidiary activities represent only a small part of the consideration compared to the principal activity,
- the subsidiary activities help or complement the implementation of the principal activity,
- the subsidiary activities are the consequence of the commitment and implementation of the principal activity.

In accordance with Tax Authority circular no. 35/1998, the above classification should be examined in the light of the actual agreement. If the conditions above are contradictory and lead to different conclusions, the main purpose of the transaction should be examined.

Tax Authority circular no. 4/2006 deals with the classification of credit assessment fees. According to the ruling, a credit assessment fee may only be treated as an independent service, and not as related to exempt financial services, if it is provided by another company as the company which grants the credit.

15.3 Actual rate of deduction of input VAT in the financial sector

Such data are not publicly available in Hungary, and therefore a detailed analysis is not possible. However, it has been estimated that the average deduction ratio is low, about 5 - 8% (not official estimation).

This relatively low ratio can be partly explained by the fact that the clientele of most Hungarian financial institutions are EU-customers.

16 IRELAND

16.1 Legal provisions relating to deduction of input VAT

16.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Section 6 of the Irish Value Added Tax Act of 1972 (the "Irish VATA"). In particular exemptions with regard to financial and insurance services are provided in the Irish VATA (see Ireland)

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

Prior to the passing of the Finance Act 1999 there was only one exempt activity in respect of which a person may waive exemption. That was the letting of immovable goods. With effect from 1 January 2000, Sec. 6A of the Irish VATA allows suppliers of investment gold, and intermediaries, within the meaning of that section, to waive exemption in respect of specific transactions, whilst retaining exemption in respect of other transactions.

16.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

In general, a deduction is granted for full input VAT, i.e. VAT payable in respect of goods and services used for the purposes of the entrepreneur's taxable supplies.

If input VAT relates to goods and services which are used partly for the purpose of taxable supplies and partly for other purposes, only a proportion thereof is available for deduction. This proportion is to be calculated on any acceptable basis under the VAT regulations which correctly reflects the extent to which the goods and services concerned are used for the former (deductible) purposes, having regard to the range of the entrepreneur's total supplies and activities. Subject to this principle, the proportion may be calculated by reference to the ratio which "deductible" turnover bears to total turnover; if necessary, the calculation may be carried out by reference to various parts of a business. There is also provision for excluding incidental financial services (e.g. receipt of deposit interest and incidental transactions in immovable property) (Sec. 12(4) VATA). If necessary, the proportion of non-deductible input VAT may be adjusted by reference to the overall position during the entrepreneur's period of account (Sec. 12(4) VATA).

If a taxable person is entitled to recover all the VAT paid on the importation, acquisition or purchase of capital goods, all the VAT incurred may be recovered during the VAT period in which the supplier's invoice is dated. Article 20 of the EC Sixth VAT Directive (adjustment of input VAT for capital goods) is not applied in Ireland.

A VAT-registered person who supplies both taxable and exempt goods or services is known as a partially exempt person (i.e. he supplies mixed transactions). VAT in respect of such transactions is recovered on the following basis. Expenditure that is directly attributable to taxable supplies is fully recoverable. Expenditure that is directly attributable to exempt supplies is not recoverable. The recovery of VAT incurred on residual expenditure that cannot be directly attributed to taxable or exempt supplies is calculated using the apportionment method (Regulation 18, VAT Regs).

"Residual VAT" is the term given to VAT incurred on the acquisition/purchase/importation of goods and services which cannot be directly attributed as having been acquired/purchased or imported in respect of the supplies of goods and services which are wholly taxable supplies or qualifying activities. Residual VAT must be apportioned between taxable and all other supplies, the former proportion being recoverable. A taxable person is only entitled to deduct VAT on his purchases of such dual use inputs to the extent that such inputs are used in making taxable supplies, having due regard to the full range of activities carried on by the taxable person. The percentage recovery rate of residual VAT must be agreed on an annual

basis with the Inspector of Taxes and it is normally revised on a retrospective basis with regard to the out-turn for the previous 12 months.

Regulation 18 requires that the proportion used to calculate input tax recovery on dual use supplies correctly reflects the extent to which the dual use inputs will be used for the purposes of the taxpayer's deductible supplies and has due regard for the range of the taxpayer's supplies and activities. Guidance on the practical application of this regulation by the tax authorities is given in "A guide to apportionment of input tax" (Revenue Commissioners, October 2001).

The guidance does not prescribe a particular method of apportionment. Rather, it is accepted that the method used will depend on the circumstances of each case. The taxpayer has the primary responsibility for the decision on what method to use. However, the taxpayer must be able to demonstrate to the satisfaction of the tax authorities on request that the result of the calculation is reasonable.

A strict application of the rules would require the taxpayer to use a new calculation for every taxable period in order to correctly reflect the use of the inputs and range of activities for that period. To ease the burden on the taxpayer, Regulation 18 permits the taxpayer to use any of the following methods:

- a method which correctly reflect the use of the inputs and range of activities for that period;
- the proportion of tax which was deductible for the previous year;
- the taxpayer's estimate of the proportion of deductible tax which correctly reflect the use of the inputs and range of activities for the current year.

If the tax authorities are not satisfied with the basis of the estimate they can require the taxpayer to use a different basis.

Although the turnover method of apportionment was traditionally seen as the standard method of apportionment, the taxpayer is only entitled to use it if the results correctly reflect the use of the inputs and range of activities (Sec. 12(4)(d) VATA). Moreover, whether or not the turnover method is used, two types of transaction must be excluded from the method if their inclusion distorts the result: incidental financial transactions and incidental property transactions (Sec. 12(4)(e)(ii) VATA).

Where it is appropriate, the taxpayer should use a sectoral approach to apportionment (Sec. 12(4)(e)(i) VATA). A sectoral approach requires a series of calculations for each sector of the business (e.g. where there are separate branches or distinct accounting divisions within a company). A sectoral approach can only be used where separate sectoral records are kept.

16.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no regulations specific to the financial services sector. The calculation of deductible input tax by businesses in this sector must follow the general rules discussed above. The guidance issued by the tax authorities states that the turnover method is not an acceptable method for use by financial institutions. The guidance sanctions the use of non-turnover based methods (e.g. based on numbers of staff or transactions) but does not suggest that any particular method will be acceptable. Whichever method is used must be supported by objective documentary evidence and meet the conditions of the legislation.

The tax authorities have not published any information regarding concessions granted to or agreements concluded with financial sector businesses or their representatives.

16.3 Actual rate of deduction of input VAT in the financial sector

The tax authorities have not published any information regarding input tax recovery rates for financial sector businesses. Information relating to taxpayers' affairs may only be disclosed in prescribed circumstances authorized by legislation.

17 ITALY

17.1 Legal provisions relating to deduction of input VAT

17.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Articles 10 to 8, 8.bis and 9 of Presidential Decree No. 633 of 26 October 1973 (the “**Italian Vat Law**”). In particular exemptions with regard to financial and insurance services are provided in Article 10(1) No. 2, 4 and 9 of Italian Vat Law (see Italy)

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if related to export.

17.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Articles 19 and 19bis) provide that VAT paid on goods and services acquired within the state by a taxable person to be used for the purposes of his business may be offset against the VAT due on supplies made by such taxable person.

However a number of restrictions are provided by Article 19(2) and 19bis1):

- i. Article 19(2) excludes the deductibility of the input VAT on goods and services purchased or imported related to exempt transactions⁶⁴ or to transactions not subject to VAT⁶⁵; and
- ii. Article 19 bis1) expressly provides several categories of goods and services on which VAT cannot be recovered.

Nevertheless, Article 19(3) of Italian VAT Law, provides an exception to the sub (i) restriction, since it lists a number of VAT-exempt or non-taxable transactions that are considered equal to taxable transactions⁶⁶.

With specific reference to Article 17(5) of the Sixth Directive, it has been implemented in the Italian VAT Law in Articles 19(4) and (5) and 19bis) with some peculiarity compared with the relevant provisions of the Sixth Directive.

If a person carries out both taxable and VAT exempt activity without the right of deduction the deductibility of the input VAT is determined on a pro rata basis. In particular Article 19(5) of Italian VAT Law states that, if a taxable person makes exempt supplies in a year, he must deduct the input VAT claimed for that year for of a percentage calculated by dividing the supplies on which the VAT is deductible recoverable (numerator) by the sum of this amount

⁶⁴ Consistent with article 17(2) of the Sixth Directive and ECJ judgement of 6 April 1995 No. C-4/94 which ruled that “...where a taxable person supplies services to another taxable person who uses them for an exempt transaction, the latter person is not entitled to deduct the input value added tax paid, even if the ultimate purpose of the exempt transaction is the carrying out of a taxable transaction”. Therefore, to give rise to the right to deduct, the goods or services in question must have a direct and immediate link with the taxable transactions, and the ultimate aim pursued by the taxable person is irrelevant in this respect.

⁶⁵ Within the meaning of this definition fall not only the exempt transaction included in article 10 of the Italian VAT Law, but also the transactions falling outside the scope of the VAT as provided by the law or because one of the three requisite is met (subjective, objective and territoriality).

⁶⁶ None of them relates to financial or insurance transactions, however, for the sake for clarity, they are:

- exports or intra-Community supplies;
- transactions outside the scope of VAT for lack of the territory requirement if the transactions would have fall within the scope of VAT if carried out within the Italian territory;
- transactions outside the scope of VAT provided by articles 2(3)(a), (b), (d), (f) of Italian VAT Law (i.e. supplies of money, transfer or contribution of a business enterprise or an independent part of such an enterprise, supply of free samples of low value marked as such, transfer of goods under a merger contract or following a change in the corporate form of the company);
- transfers of gold for investment performed by entrepreneurs who produce gold for investment or transform gold into gold for investment purposes; and
- non-taxable transactions in accordance with Art. 74(1), (8) and (9) of D.P.R. 633/1972 (i.e. supply of excise goods, newspapers, books, telephone cards, waste and scrap metals, paper, etc.).

This provision is consistent with article 17(3) of the Sixth Directive.

and the exempt supplies in the same year (denominator). The result is rounded up or down to the nearest whole number. For this purposes it is not relevant whether the purchase is exclusively related to an exempt or to a taxable supply.

Exempt supplies that are ancillary to the main activity of the taxable person are not taken into account for the purpose of the determination of the general pro rata of deduction. However, in such a case, input VAT on purchases specifically made for rendering such ancillary exempt supplies is not deductible. This rule hardly applies to financial institutions since exempt financial activities normally constitute their core business.

During the VAT year the taxpayer provisionally deducts input VAT using the pro rata percentage for the previous VAT year. The amount of VAT deducted is revised retrospectively, when the annual VAT return is submitted, using the actual pro rata percentage for the year. A new business which makes exempt supplies uses a "presumed" recovery percentage for its first VAT year.

(a) Financial and insurance services

Italian VAT Law, consistent with Articles 17(5) and 22(9) of the Sixth Directive, provides for (i) the election to apply the pro rata to separate sector of activities (Article 36(3) of Italian VAT Law) and (ii) the option not to keep books and records for exempt transactions (Article 36*bis* of Italian VAT Law)

In particular:

- Article 36(3) of Italian VAT Law, provides that taxable persons who carry on more than one business activity, within the same legal entity, may elect to account for VAT separately on each activity, as if it were a separate business entity. Each separated part of the business must keep independent VAT records. Goods and services are directly attributed to each separated part of the business. The pro rata is then applied, based on the taxable and exempt supplies made in each. VAT must be accounted for on any goods and services supplied by one separated part of the business to any other part, if it is partially exempt.

Once exercised, this election is in force for 3 years.

- Article 36*bis* of Italian VAT Law provides that taxable persons who make exempt supplies may also elect not to recover any VAT, in return for being excused many of their administrative obligations. In fact, even if, in general, exempt taxable persons are required to maintain the same VAT records as other taxable persons, the fully exempt persons are not always obliged to submit an annual VAT return. A fully exempt or partially exempt taxable person may also opt to reduce his administrative obligations. In which case he is not obliged to issue tax invoices or maintain output tax registers for exempt supplies made. A person who opts to use the scheme must still issue tax invoices and maintain records relating to taxable supplies and relating to supplies received. Once this option is exercised, the taxable person may not deduct any input VAT on supplies of goods and services received (i.e. VAT becomes merely a cost). This option is, therefore, normally only exercised by taxable persons who recover little VAT anyway, because they wholly or mainly make exempt supplies, such as banks or insurance companies.

The option lasts until revoked, subject to a minimum period of 3 years.

17.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

No particular practices with regard to the right of deduction of input VAT, containing provisions deviating from the rules above described, are provided in Italy for banking or insurance sector.

However, it is worth noting that Article 6 of the Law No. 133 of 13 May 1999 introduced a special VAT regime for services having an ancillary character and being supplied within banking and insurance groups or, in general, within groups of companies carrying out mainly VAT-exempt activities. According to this provision, if certain conditions are met, these services shall be considered VAT exempt. In this respect, Article 6 can be considered as a sort of implementation measure of Article 4(4) of the Sixth Directive, even though (i) it is

limited to the financial sector and (ii) maintains the separate VAT personality of the different entities belonging to the group.

Prior to the introduction of this Article 6, the outsourcing of in-house services within groups carrying out mainly exempt activities had been prevented or at least curbed since it would automatically generated an additional cost constituted by the VAT charged.

For completeness of information, the above exemptions apply:

- when ancillary activities are supplied within banking group, including banking groups controlled by EC banks or financial institutions, insurance group, consortia of insurance companies, and groups of companies carrying out mainly exempt (i.e. whose exempt activities represent at least 90% of their overall turnover);
- activities having the characteristics of being: (i) “ancillary” to the main activity carried out by the group of companies considered by Article 6 and (ii) supplied “exclusively” within the group, i.e. from one group company to another.

17.3 Actual rate of deduction of input VAT in the financial sector

There is not formal and/or official information. However, based on our investigation:

- (i) for the banking system as a whole (i.e. including all the financial institution regardless if they have exercised the option provided for by Article 36(3) or 36*bis* of the Italian VAT Law) the “real” general pro rata deductibility is equal to 1,70%;
- (ii) if we take into consideration the same sector but excluding these financial institutions that exercised the election to apply the pro rata to separate sectors, the actual general pro rata of deductibility is equal to 1%.

It is worth noting that approximately 30% of the banks applies for the application of the general pro rata, whilst the 70% of the bank companies apply for the option provided by Article 36*bis* of Italian VAT Law. Among this last 70%, 22% also exercised the election for separate business and, therefore, separate pro rata.

No data are available for insurance companies.

18 LATVIA

18.1 Legal provisions relating to deduction of input VAT

18.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Article 6(1) of the Law on the Value Added Tax (the “**Latvian VAT Law**”). In particular exemptions with regard to financial and insurance services are provided in Article 6(1)13) and 17) of the VAT Law (see Latvia)

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

The Latvian VAT Law does not provide for a waiver of exemption or an option for taxation.

18.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

The rules on the deduction of input VAT are laid down in Article 10 of the Latvian VAT Law. The more detailed guidance is provided in the Regulation of the Government on the application of the rules of the VAT Law of 21 November 2006 (the “**Regulation**”).

Under Latvian rules and in line with the rules of the Sixth Directive, input tax can be generally deducted by a registered taxpayer for goods and services used to ensure taxable transactions of the taxpayer (Article 10(1) of the Latvian VAT Law). The Regulation further clarifies that no input VAT can be deducted for goods and services received to ensure transactions that are tax-exempt (point 194 of the Regulation). However, tax on goods and services used for tax-exempt insurance and financial services is fully deductible if these are supplied to customers registered in a third state or territory and not registered in any EU Member State (Article 10(1)6a) of the Latvian VAT Law). In addition, the VAT is deductible with respect to tax-exempt insurance services if transactions are directly related to the export of goods (Article 10(1)6b) of the Latvian VAT Law).

Under general rules, taxpayers carrying out taxable and tax-exempt transactions are normally allowed to choose between calculation of input VAT on the basis of actual use or on the basis of the pro rata. If a taxpayer ensures separate accounting for goods and services used for taxable and tax-exempt transactions, input VAT is deductible with respect to goods and services used to ensure taxable transactions of a taxpayer (actual use, Article 10(9) of the Latvian VAT Law). If separate accounting is not ensured, a taxpayer must calculate deductible VAT on the basis of the following apportionment (pro rata, Article 10(10) of the Latvian VAT Law):

- **Numerator:** the value of taxable transactions carried out, net of tax (including the zero-rated transactions)
- **Denominator:** the total value of transactions carried out net of tax, i.e., the sum of the amount included in the numerator and of the tax-exempt transactions, which are listed in Article 6(1) of the Latvian VAT Law.

There is, however, one clear-cut restriction when calculation of the pro rata is not allowed. The taxpayer *must* determine deductible input VAT on the basis of actual use when the value of taxable transactions carried out by a taxpayer in the year preceding the taxable year is less than 5% of the total value of the transactions carried out (Article 10(11) of the Latvian VAT Law). Conversely, a taxpayer is entitled deduct all input VAT incurred without calculation of a pro rata deduction when the value of taxable transactions exceeds 95% of the total value of transactions carried out (Article 10(11¹) of the Latvian VAT Law).

There are certain general rules clarifying the calculation of turnover for the purposes of the application of the pro rata formula.

First, if a taxpayer carries out one tax-exempt transaction during taxable year, which is clearly unrelated to the taxpayer's business, the value of such transaction may be excluded from the

calculation of the pro rata (Article 10(11²) of the Latvian VAT Law). Such transaction must be different from the type of the taxpayer's business and must not be repeated systematically throughout the year (point 259 of the Regulation). There is no further guidance with respect to which transactions are considered to be unrelated to the financial or insurance business and can be excluded from the calculation of the pro rata formula.

Secondly, the general rule is that the value of the taxable transactions (i.e., the numerator) must include the value goods and services supplied by a taxpayer as well as self-supplies (point 254 of the Regulation). The value of goods imported, the value of intra-EU acquisitions as well as the value of received services for which a taxpayer paid tax as a recipient of services, is excluded (point 254 of the Regulation). A taxpayer supplying listed tax-exempt financial and insurance services (Article 6(1) 13) and 17) of the Latvian VAT Law) in calculation of the pro rata, must include in the numerator financial and insurance services supplied to persons registered in a third state or territory and not registered in the EU (point 255 of the Regulation). Similarly, the numerator must also include insurance services listed in Article 13(1) 13) of the Latvian VAT Law directly related to the export of goods.

As the taxable period for VAT purposes is one calendar month, the pro rata is calculated and input VAT is deductible accordingly, based on the data relating to the tax period. A taxpayer who carried out taxable and tax-exempt transactions throughout the taxable year and separate accounting has not been kept, must re-calculate the pro rata for the taxable year applying the rules set out above before submission of the yearly tax return (Article. 11 (6¹) of the Latvian VAT Law). The amount of input tax is to be corrected, if necessary, and any resulting tax due is to be remitted to the budget before the yearly return is submitted.

Although not directly relevant in the context of the research assignment, there are rules on the adjustment of the input tax calculated on the basis of the pro rata in situations of the disposal of immovable property (within 10 years from the commencing to use) and movable assets (5 years) for which input VAT has been initially deducted.

18.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

All the general rules outlined above are equally applicable to the financial sector. The 5% restriction on the calculation of the pro rata may be particularly relevant for the financial industry operators. In addition, the Regulation lays down the number of rules on the calculation of the turnover with respect to tax-exempt financial transactions.

The general rule is that the value of a service is its market value excluding VAT (Article 2(4) of the Latvian VAT Law). It includes all expenses, other taxes or duties related to the service (Article 2(7) of the Latvian VAT Law). Taxpayers carrying out tax-exempt financial services, when calculating the value of services carried out, must follow a number of specific rules with respect to certain types of financial services:

- a. Value for money lending transactions. The value of credit and money lending transaction is the amount of interest paid for the loan plus the amount of related commission charged for the service (point 26 of the Regulation).
- b. Value for currency, financial instruments and securities trading. For these transactions (including futures trading), in line with *The First National Bank of Chicago v. Commissioners of Customs and Excise*, Case C-172/96, [1998] ECR I-4387, the value is the difference between the purchase amount and proceeds from sale (point 27 of the Regulation). The value is to be determined for all transactions within the taxable period. When calculating the yearly adjustment for the yearly tax return, the previously calculated positive and negative amounts are summed up.

Apart of those rules of general applicability, there is no publicly available further more detailed guidance. It is possible that individual clarifications have been provided to the taxpayers with respect to application of the rules to actual circumstances. However, such individual clarifications are not to be disclosed by the authorities under the law, unless a general clarification is made public by authorities on their own initiative.

One of clarifications that has been made public and is only indirectly relevant within the context of research assignment is the letter of the State Revenue Service dated 29 June 2006

No. 15.2.1-9/17559 on the delimitation of tax-exempt financial services and other taxable services.⁶⁷ The letter clarifies that a service whereby a person undertakes to find and present the list of potential clients to a bank is treated as a taxable service. Where such person, in addition to finding clients, prepares necessary documents to open bank account and presents the documents together with the client list to a bank, such services are treated as tax-exempt financial services.

18.3 Actual rate of deduction of input VAT in the financial sector

The statistical information on actual average rate of deduction of input VAT in the financial sector is not available, as such information is not collected in Latvia.

One of the peculiarities of Latvian banking system is that the number of banks provides services mainly to customers established outside the EU (e.g. Ukraine or Russia) while the others are mainly locally-oriented. This is also one of the factors which normally has an impact on the calculation of the pro rata. According to the unofficial information received from one of the banks whose clients are mainly established in Latvia, the average applicable pro rata is 2%.

⁶⁷ Available in Latvian only on the home page of the Latvian State Revenue Service at http://www.vid.gov.lv/dokumenti/tiesibu_akti/vid%20vestules/pvn/pvn_29062006_nr.15.2.1-9_17559.doc.

19 LITHUANIA

19.1 Legal provisions relating to deduction of input VAT

19.1.1 General overview of exemptions according to the domestic law

The main provisions concerning VAT deduction are contained in the Lithuanian VAT Act No. IX-751 of 5 March 2002 (as subsequently amended) (the "**Lithuanian VAT Act**").

Pursuant to Art 57 Part 1 of the VAT Act, input VAT⁶⁸ may be deducted by VAT payers⁶⁹ (except those to whom the provisions on electronically rendered services⁷⁰ apply). To note, VAT payers who have been registered only due to acquisition of goods from other Member States but do not perform any economical activity are not entitled to VAT deduction. However, these and other persons may deduct VAT in respect of supply of new transport vehicles to other Member States.

The basic principle governing VAT deduction is set in Art 58 Part 1 of the VAT Act, stating that a VAT payer may deduct VAT for acquired or imported goods and services, if these goods and services are designated to be used for supply of VAT taxable goods and services by that VAT payer. VAT may also be deducted in so far as the goods and services are used for supplies outside Lithuania provided such supplies would be deemed VAT non-taxable if they had been taken place in the territory of Lithuania⁷¹.

A taxable person rendering financial services mentioned in Items (i)-(iv) of the list attached in Annex 1- Lithuania, may choose to levy VAT on these services, if a purchaser (client) is a VAT payer. The choice shall be valid for at least 24 months and in respect of all the transactions of that taxable person.⁷²

Insurance services

Pursuant to Art 27 of the Lithuanian VAT Act, VAT non-taxable services include insurance and re-insurance of all types⁷³, as well as related services rendered by insurance brokers and agents (see Lithuania).

19.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

De minimis rule

Consistent with the Sixth Directive Art 17 (5)(e), the Lithuanian VAT Act (Art 60 Part 6) establishes *de minimis* rule whereby all the input VAT may be attributed to VAT taxable activity and may be deducted provided that at least 95% of input VAT is attributable to VAT taxable activities.

"Direct use" criterion

Art 59 Part 1 of VAT Act provides that a VAT payer who is engaged in mixed activities (i.e. where some of the activities are VAT taxable and the other ones are not) shall apportion input VAT (as much as it is possible according to the accounting data) to each type of the activities, depending on what activities goods and services are to be used for. There must be a direct link between goods and services in respect of which VAT is deducted and the activity of a VAT payer giving rise to VAT deduction (as per Art 58 Part 1 of the VAT Act).

Pro rata criterion

According to Art 59 Part 2 of VAT Act, if it is impossible to attribute directly the input VAT to a particular activity, it shall be apportioned proportionally. Thus, the direct use criterion is

⁶⁸ Deductible VAT includes purchase VAT and import VAT (Art 57 Part 2 of the VAT Act).

⁶⁹ There are specific rules on VAT deductions for individuals who are VAT payers (Art 61 of the VAT act and Order No. 1K-112 of the Minister of Finance of 8 April 2004).

⁷⁰ Chapter XII Section 5 of the VAT Act.

⁷¹ This condition is not applicable for insurance services or financial services (as listed in Art 28 of the VAT Act) rendered outside of the Community.

⁷² Art 28 Part 7 of the VAT Act.

⁷³ Except for insurance services directly linked to the export of goods (not covered by intra-Community non-taxable supplies) from the Community which are zero-rated (Art 46 of the VAT Act).

prevailing but a part of input VAT which cannot be apportioned on a direct use basis shall be pro rata divided into deductible and non-deductible portions.

The pro rata formula is that a percentage of input VAT which is attributable to VAT taxable activities (and therefore deductible) must correspond to the portion of income from VAT taxable supplies (VAT excluded) in the total income (VAT excluded) of a VAT payer.⁷⁴ The percentage must be rounded up to whole figures.

For the purposes of calculating the pro rata portion of deductible VAT, the following types of income are ignored:

- the income from the supply of fixed assets used in the activities of a VAT payer;
- the income from supply of immovable property and financial services (covered in Art 28 of the VAT Act) if these transactions are occasional and a VAT payer is not regularly engaged in such activities.

Furthermore, in the cases and procedure established by the Minister of Finance⁷⁵, when calculating this proportion the amount of received and consumed subsidies shall be added to the total income.

Following the Official Commentary to the VAT Act, "total income" (as denominator in the pro rata formula) does not include received dividends or any other income from shares, as well as income from holding of securities, income from bank deposits, bank accounts or bank cards, extraordinary gains, and similar receivables which are not "income from activity".

When calculating the portion of deductible VAT, results of the previous calendar year shall be used. If such results are not available, then forecasts by a VAT payer (concerted with the local tax administrator) shall be used. The portion must be used the whole year. After the end of a calendar year the deductible VAT portion is subject to adjustment according to the actual results of that year.⁷⁶

Other criteria

The VAT Act provides for a possibility to use other criteria than the direct use or the pro rata deduction.

Art 60 Part 2 of VAT Act says that if, in the opinion of a VAT payer, a portion of input VAT attributable to the VAT taxable activity according to the pro rata criterion does not reflect the real use of assets, he may refer to the local tax administrator in writing asking to use another apportionment criterion.

The other criteria may be an actually used area of buildings, or an actually used capacity of the machinery or any other criterion which, in the opinion of a VAT payer, realistically shows the proportion of use of relevant assets.

The local tax administrator will satisfy the request provided results of the pro rata apportionment and the apportionment according to the criterion requested by a VAT payer differ substantially to the disadvantage of the VAT payer and the application of the requested criterion will not impede reasonable control of VAT deduction and its adjustment. The criterion approved by the local tax administrator cannot be later changed.

It should also be mentioned that the local tax administrator may compel a VAT payer which apportionment criterion shall be used in respect of particular goods or services.⁷⁷ This is the case when the immovable property is used in mixed activities and the deductible VAT portion established on pro rata basis unreasonably gives a substantial advantage to a VAT payer. The local tax administrator may instruct a VAT payer to apply the apportionment criterion which realistically reflects the use of goods and services. If a VAT payer disagrees with such an instruction, he may appeal the decision of the tax administrator under the general procedure.

⁷⁴ Art 60 Part 1 of VAT Act.

⁷⁵ Order No. 1K-107 of the Minister of Finance of 31 March 2004.

⁷⁶ Art 60 Part 5 of the VAT Act.

⁷⁷ Art 60 Part 4 of VAT Act and Order No. 356 of the Minister of Finance of 12 November 2002.

19.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no special rules or publicly available practice concerning the VAT deduction for financial service and insurance sectors.

19.3 Actual rate of deduction of input VAT in the financial sector

Information on national actual pro rata for financial service and insurance sectors is not available.

20 LUXEMBOURG

20.1 Legal provisions relating to deduction of input VAT

20.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Articles from 43 to 47 of the law dated 12 February 1979 (*Taxe sur la valeur ajoutée* - the “**Luxembourg VAT Code**”). In particular exemptions with regard to financial and insurance services are provided in Article 44(1)c) and d) of the said Luxembourg VAT Code (see Luxembourg).

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

It is worth noting that the Luxembourg VAT Code expressly include among the financial services also the issuance of securities which represent a deviation from the Sixth Directive. It is believed that this provision does not broaden the arrangement fees by the manager of an issue. It is stated that advisory services provided by lawyers in relation to such VAT exempt services are not covered by these exemptions.

In general, the Luxembourg VAT system does not allowed the taxpayer to opt for the application of VAT.

Luxembourg VAT Code does not contain a definition of financial services. The only reference contains the provision on the place of supply rules applicable to intangible assets, which refers to “banking and financial transactions”⁷⁸. Furthermore, the Luxembourg administration has indicated that it will follow the decision of the ECJ in *Sparkassenes Datacenter (SDC)*⁷⁹ in which it was held that financial services may be rendered by regular banks and credit institutions. The Luxembourg VAT Code does not contain any reference to the Luxembourg banking law. However, Luxembourg scholars have indicated that financial services should be interpreted by means of the concepts defined in Luxembourg banking law.⁸⁰

Besides the exempt financial services, the Luxembourg VAT administration has clarified that the following services are subject to VAT at the rate of 12%:

- a) direct and indirect custody of securities;
- b) follow-up of dividends/interest due dates and payment, eventually via coupon;
- c) follow-up of corporate events and informing clients of term such as coupon renewal, franking, change of denomination, takeover bids, share exchange offers, follow-up notices of redemption and the provision of statements and portfolio valuations.

Advisory and management and data processing services supplied by a bank are normally subject to tax. The term “advisory services” includes portfolio management services subject to the rate of 15%.

Further, any activity that is ancillary to financial exempt services is exempt as well.

Luxembourg tax law does not provide for the possibility to opt for taxation with respect to exempt financial services.

20.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Concerning the deduction of input VAT, Luxembourg follows the rules laid down by the Sixth Directive, under which input VAT relating to goods and services is only deductible where those goods and services are actually used for the purposes of carrying out taxed

⁷⁸ Art. 17(2)(e) of the Luxembourg VAT Act (*Taxe sur la valeur ajoutée*).

⁷⁹ Case C-2/95 *Sparkassenes Data Center* [1997] ECR I-3017.

⁸⁰ C. Emond, *La TVA sur les prestations de services financiers*, Livre Jubilaire de l'association des Juristes de Banque, Larcier 1994, at 463.

transactions, i.e. there must be a direct link between the goods and services and their use for taxed purposes⁸¹.

However, with respect to the deduction of the input VAT, Luxembourg takes a rather flexible approach. The Luxembourg VAT Code regulates that the determination of a deduction using a pro rata method is given priority over the direct allocation of goods and services used to taxable and tax exempt transactions⁸². Various methods are allowed to calculate the deductible proportion of VAT.

The main rule to calculate the deductible pro rata (i.e. the general pro rata) is equal to a fraction of which:

- the **numerator** consists of the total amount of turnover in respect of transactions for which VAT is deductible; and
- the **denominator** is the amount of all transactions⁸³.

The turnover is based on the supply of goods and services during the calendar year.

The tax administration may authorize or oblige the taxpayer:

- (a) to apply a direct allocation method based on actual use for the determination of the deductible input VAT; in this case, input VAT in relation to exempt services is not deductible, or
- (b) to divide its activities into various sectors, and calculate a specific pro rata for each sector⁸⁴.

The pro rata must be calculated on an annual basis. During the year, a provisional pro rata is applied on the basis of the preceding year's transactions. In the absence of any such transactions or where they were insignificant in amount, the pro rata is estimated provisionally under supervision of the administration by the taxable person based on the taxable person's own estimates. The deductions made on the basis of such a provisional pro rata will be adjusted when the final pro rata is fixed during the next year. However, where such a figure is either not available or is insignificant, a provisional proportion is estimated by the entrepreneur according to its projections which are controlled by the tax administration.

The pro rata is expressed as a percentage rounded up to a higher figure. For instance, if the pro rata of a bank is 0.1%, the bank may deduct 1% of its input VAT.

Finally, as a simplification measure, input VAT is fully deductible under condition that the calculated pro rata is 90% or more and the fiscal advantage for taxpayers resulting from a non application of the pro rata method does not exceed 250 EUR for the calendar year in question.

The final proportion for a year must be determined and if necessary the pro rata must be adjusted in the annual declaration⁸⁵.

20.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

No particular practices with regard to the right of deduction of input VAT, containing provisions deviating from the rules above described, are provided in Luxembourg for banking or insurance sector.

20.3 Actual rate of deduction of input VAT in the financial sector

In Luxembourg the pro rata of banks is generally situated somewhere between 10 and 20% (nearer to 10 than to 20%)⁸⁶. The pro rata varies depending on the – in some cases very

⁸¹ Art. 49(1) VATA

⁸² Art. 51 VATA

⁸³ Art. 50(1) VATA and Decree Grand-Ducal of 21 December 1979, published in the Official Gazette of 27 December 1979, p. 2130.

⁸⁴ Art. 50 VATA.

⁸⁵ Art. 52(3) VATA.

⁸⁶ This information was received from the Luxembourg banking association (*Association des Banques et Banquiers Luxembourg (ABBL)*).

Survey on the recovery of input VAT in the financial sector
December 2006

limited - activities of certain Luxembourg banks (compared to the universal banks system generally applicable in Luxembourg) and depending on the fact whether there are activities conducted with clients outside the EU or not. Further detailed information is not available pursuant to secrecy obligations.

21 MALTA

21.1 Legal provisions relating to deduction of input VAT

21.1.1 General overview of exemptions according to the domestic law

Exemptions from VAT are contained in Article 22 of the Malta Value Added Tax Act, Chapter 406 of the Laws of Malta (the “**Malta VAT Act**”). In particular exemptions with regard to financial and insurance services are provided in Part 2 of the Fifth Schedule of Malta VATA (see Malta).

In line with the provisions of the Sixth Directive, in general, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. Insurance and financial transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

21.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

In terms of the general principle of deductibility, the input VAT is fully deductible in so far as it is incurred for the purposes of making taxable (including exempt with credit) supplies and such recovery is restricted where the taxable person makes exempt (without credit) supplies.

The terms and conditions governing deductibility of input tax are laid out in the Tenth Schedule to the Malta VAT Act, which establishes the principles of direct and partial attribution, essentially providing that:

- Input tax, which is exclusively attributable to taxable supplies, is allowable as a credit (direct attribution).
- Input tax, which is exclusively attributable to exempt supplies, is not allowable as a credit.
- Input tax attributable to both categories of supplies is partially recoverable, in accordance with the partial attribution rules in item 6 or 8 of the Tenth Schedule Malta VAT Act.

In terms of the rules in the Tenth Schedule VAT Act, where goods and services are used for mixed purposes (i.e. for the purposes of making both taxable/exempt with credit and exempt without credit supplies), the allowable deductible portion of input tax is computed by dividing the sum total of the value of all exempt supplies listed in Article 22(4) made by the Malta VAT-registered person during a calendar year by the sum total of the value of ALL supplies made during the said calendar year, which will result in the definitive ratio for the given year and the provisional ratio for the subsequent calendar year. For each VAT (quarterly) period, the provisional recoverable input tax is identified by multiplying the value of the input tax for the period by the provisional ratio. The total input tax credit allowable for a calendar year shall be determined by multiplying the total input tax for all VAT periods for the year by the definitive ratio for that year. The difference between the total provisional input tax for the calendar year and the definitive amount shall represent either additional VAT due by the taxable person or a deduction allowable, which amount is to be accounted for in the tax return for the first tax period of the next calendar year.

In calculating the deductible portion of VAT, for the purposes of determining the value of supplies made, the value of supplies of capital goods (detailed rules exist with regard to the adjustment of input tax recovered on purchases of capital goods), self-supplies and supplies which are not deemed to have been made by a taxable person acting as such shall be excluded.

Item 9 of the Tenth Schedule Malta VAT Act establishes a *de minimis* partial attribution limit in terms of which, where pursuant to an apportionment computation, the amount of unrecoverable input tax is less than MTL 10 multiplied by the number of months/part thereof included in the relevant VAT period, the said amount shall be allowable as a deduction.

In terms of item 8 of the Tenth Schedule Malta VAT Act, the Commissioner may, by Notice in writing, permit a taxable person to apply an alternative method of partial attribution where it appears that the standard partial attribution method does not lead to a fair and reasonable result. We understand that, to date, no such alternative method of partial attribution has been negotiated with the VAT authorities.

21.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

In terms of guidance notes issued by the Malta VAT Department on the matter, the methodology adopted in the computation of the deductible portion of VAT in accordance with the partial attribution rules is as follows:

- (a) classification of output and input operations;
- (b) classification of output operations into taxable (including exempt with credit) supplies and non-taxable/exempt without credit supplies in order to determine the value of the relevant outputs respectively;
- (c) elimination of amounts not to be taken into account in determining the taxable value;
- (d) elimination of expenses not related to the economic activity and expenses on which no VAT was due;
- (e) calculation of the provisional ratio and determining the input tax deduction allowable for the relevant VAT period;
- (f) calculation of the definitive ratio and determining the input tax deduction allowable for the relevant calendar year;
- (g) comparing the total provisional input tax for the calendar year and the definitive input tax for that calendar year;
- (h) Regularization in favour of the VAT Department or the taxable person.

We are not aware of any other particular administrative practices applied by the local authorities in relation to input tax recovery by local financial services operators.

21.3 Actual rate of deduction of input VAT in the financial sector

To our knowledge, no statistics/information on the rate of input tax recovery by local financial services operators has been made publicly available.

22 NETHERLANDS

22.1 Legal provisions relating to deduction of input VAT

22.1.1 Preliminary observations

Unlike the rules laid down by the Sixth Directive, under which input VAT relating to goods and services is only deductible where those goods and services are actually used for the purposes of carrying out taxed transactions (there must be a direct link between the goods and services and their use for taxed purposes), Article 15(1) of the VAT Act⁸⁷ is based on the principle, that entrepreneurs⁸⁸ are entitled to deduct input VAT, in so far as they use goods and services in the course or furtherance of their business for purposes other than carrying out exempt transactions. However, Article 15(2) provides that, in so far as entrepreneurs use the goods and services for the purpose of carrying out exempt transactions, the tax can be deducted if it relates to supplies referred to in Article 11(1)(i), (j) and (k) of the VAT Act (providing for exemption for financial services and insurance transactions), provided that the customer is resident or established outside the Community or that those goods or services are directly related to goods destined to be exported to a place outside the Community.

Although the points of departure are different, the scope of the right to deduct input VAT under Dutch law is in practice generally the same as that under the Sixth Directive. Nonetheless, under the Budget 2007, the right to deduct input VAT under Dutch law will formally be adapted to the 'European' principle.

For the purposes of the above arrangements, the concept of 'exemption' is limited to transactions within the meaning of Article 13 of the Sixth Directive, i.e. those which generally do not give rise to the entitlement to deduct input tax. Those exemptions, which are laid down by Article 11 of the VAT Act (see Netherlands), must be distinguished from exemptions in the framework of which input tax is deductible. The latter exemptions or, in the terminology of the VAT Act, zero rated transactions, are laid down by Table II annexed to the VAT Act.

Article 11(1) (i), (j) and (k) provides for an exemption for financial services and insurance transactions (see Annex 1 to this report). The Netherlands has not availed itself of the option laid down by Article 13(C) of the Sixth Directive to the effect that entrepreneurs are enabled to opt for taxation of financial services. The exemptions under Article 11(1)(i), (j) and (k) of the VAT Act are compulsory.

22.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Under Article 15(6) of the VAT Act, as regards deduction of the tax, in the case entrepreneurs use goods and services for both business and non-business or exempt purposes (mixed purposes), detailed rules must be made by Ministerial Order (see Articles 11 to 14 of the VAT Implementing Order⁸⁹).

Article 11(1) of the VAT Implementing Order provides that, where entrepreneurs carry out transactions referred to in Article 11 of the VAT Act (exempt transactions) not giving rise to the entitlement to deduct input VAT, as well as other transactions, deduction of the tax under Article 15(1) of the Act (input VAT) must take place on the basis of the following rules.

- a. in respect of goods and services exclusively used for the purpose of carrying out transactions referred to in Article 11 of the Act not giving rise to the entitlement to input VAT deduction, input VAT is non-deductible under all circumstances;
- b. in respect of goods and services exclusively used for the purpose of carrying out other transactions, input VAT is fully deductible;

⁸⁷ *Wet op de omzetbelasting 1968* (Turnover Tax Act 1968).

⁸⁸ The legal term "entrepreneur" is identical to the Community term "taxable person" defined in Art. 4 of the Sixth Directive, see ECJ judgment of 12 June 1979 in *Ketelhandel P. van Paassen bv v. Staatssecretaris van Financiën/Inspecteur der invoerrechten en accijnzen and Denkvit Dienstbetoon BV v. Minister van Financiën*, Cases 181/78 and 229/78, [1979] ECR 2063.

⁸⁹ *Uitvoeringsbeschikking omzetbelasting 1968* (Turnover Tax Implementing Order 1968).

- c. in respect of other goods and services, only that part of the input VAT is deductible which corresponds to the ratio of the entrepreneur's total consideration derived from the other transactions to that derived from all transactions ("pro rata").

However, Article 11(2) of the VAT Implementing Order provides that, where it is found that, taken as a whole, actual use of the goods and services used for mixed purposes deviates from the pro rata, input VAT in respect of those goods and services is deductible on the basis of their actual use.

Consequently, unlike the Sixth Directive, the Dutch legislation provides for an order of precedence: deduction of input VAT on the basis of actual use takes precedence over the pro rata.

Article 12 of the VAT Implementing Order, *inter alia*, provides that the pro rata and actual use methods of input VAT deduction must be based on data relating the tax period during which the tax is charged to the entrepreneur or the tax has become chargeable. Provisional deductions made in the course of the financial year must be adjusted through the VAT return for the last tax period of the year, on the basis of data relating to the entire financial year.

Article 14 of the Implementing Order provides that the disposal of used business assets is not treated as a transaction for the purposes of the pro rata.

Articles 13 and 13a of the Implementing Order are not directly relevant in the context of this report. Article 13 of the VAT Implementing Order provides for the rules relating to adjustments of the input VAT which has initially been deducted in respect of movable and immovable capital business assets. Those adjustments must be made in the four and nine years, respectively, following the year in which the assets were taken into use. The annual adjustments must be made at the end of each financial year on the basis of the rate of recovery of input VAT applicable to the past year, unless the adjustment is less than 10%. Article 13a of the Implementing Order provides for a similar adjustment in the case the business assets are disposed of in the course of the adjustment period.

22.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

As regards the right to deduct input VAT in the banking sector, Administrative Notice No. 282-15703 of 9 November 1982 provides further clarification of the legal provisions. A similar Notice applicable to institutions engaged in insurance transactions does not exist.

Notice 282-15703, which applies from 1 January 1979, reiterates that, for the purpose of determining the rate of deduction of input VAT in respect of banking transactions, Article 11 of the VAT Implementing Order must be taken as a starting point, which implies that, in respect of goods and services exclusively used for the purpose of carrying out exempt transactions, input VAT is non-deductible, whereas, in respect of goods and services exclusively used for the purposes of carrying out transactions subject to VAT, input VAT is deductible in full. In respect of goods and services used for mixed purposes, i.e. for the purpose of carrying out both taxed and exempt transactions, input VAT is deductible in proportion to turnover derived from both categories of transactions or on the basis of direct use.

In so far as input VAT relating to exempt transactions is deductible, *inter alia*, in respect of financial and insurance services rendered to customers resident outside the Member States of the European Communities, the Notice explicitly mentions that that right can under no circumstance be extended to services rendered to other non-resident customers, even if the services are deemed to be rendered outside the Netherlands, i.e. at the place where the non-resident customer is resident or established.

For the purposes of deduction of input VAT, goods and services used for the purpose of carrying out exempt transactions in respect of which input VAT is nonetheless deductible must be treated as if those goods and services were used for taxed transactions. For example, goods used by banks for the purpose of carrying out exempt transactions for both customers resident or established within the Member States of the European Communities and customers resident or established elsewhere, the rate of deduction must be determined on the basis of turnover (*pro rata*) or direct use. In principle, the rate of deduction must be

based on the pro rata. Only in respect of specific goods and services, deduction of input VAT must be based on actual use.

In view of the conditions prevailing in the banking sector, it is allowed that, in respect of all goods and services used for mixed purposes, deductible input VAT is determined on the basis of the pro rata, in so far as those goods and services are used for purposes that are typical for the banking sector. In other words, in respect of transactions that are typical for their business, banking institutions may deviate from the legal principle that input VAT deduction on the basis of actual use must take precedence over the pro rata. However, where immovable property is partly used for staff facilities (staff canteen or parking spaces for staff), deduction in respect of use of the property as a whole (cost of the property itself, energy, etc) *must* be based on the pro rata.

As regards deduction of input VAT on the basis of the pro rata, the following principles apply:

- d. turnover derived from the granting of credit, including interest interventions, is the amount received by the bank under the heading interest, commission, etc. Those amounts must not be reduced by the interest paid by the bank for the purposes of acquiring the financial means necessary to grant the credit;
- e. turnover derived from currency interventions is the balance of the selling and purchase prices of the currency, which means that, in respect of those transactions, the bank's turnover is limited to its commission. Apportionment of turnover derived from supplies made to customers resident within and outside the European Communities must be made in proportion to the total selling price for the currency to both categories of customers.

Turnover derived from the exchange of currency at the counter must be determined on the same basis. Since, in respect of those transactions, the place of residence or establishment of the customer cannot be determined, that turnover must be attributed to exempt transactions (presumably, the phrase 'exempt transactions' must be interpreted as meaning 'transactions in respect of which input VAT is non-deductible');

- f. turnover derived from transactions in shares on behalf of a third party consists of the commission received by the bank, to be increased by the difference between the selling and purchase prices of the shares, i.e. the bank's gross profit margin.

In view of the minor importance of those transactions, the sale of shares that form part of the bank's own portfolio can be ignored for the purpose of the pro rata. Interest received on bonds that form part of the bank's own portfolio must be included in the turnover. On the other hand, dividends arising from shares in businesses in which the bank participates are not considered as turnover for the purposes of the pro rata.

- g. turnover derived from supplies of gold and silver, including gold and silver coins, must be determined on the basis of the total amount charged to the bank's customers. Input VAT relating to those goods is fully deductible, unless the supply is exempt.
- h. transactions that are not typical for the banking sector or of lesser importance to that sector include, *inter alia*:
 - supplies and lettings of immovable property;
 - application of self-produced goods for exempt purposes;
 - supplies of goods provided to the bank as collateral security;
 - disposal of used business assets;
 - exploitation of staff canteens (provision of food and drink to staff).

Turnover derived from those transactions must be ignored for the purposes of the pro rata applicable to goods and services used for mixed purposes. Input VAT relating to goods and services used for the purpose of carrying out the transactions in question is deductible in accordance with the normal rules, on the understanding that, in respect of VAT on expenses incurred on the accommodation used for the purpose of providing food and drink to staff, the general pro rata must in principle be applied. For example, where

supplies of goods made by banks in their capacity as fiduciary owner are subject to VAT, input VAT relating to those transactions is fully deductible;

- i. where banks grant credit by means of renting out business assets to third parties under a contract of finance lease, in view of the fact that, from the perspective of the bank, the transaction consists of the granting of credit, only the interest included in the rental or lease payments must be taken into account for the purposes of the pro rata. In so far as the interest is not subject to VAT, the interest must be treated as turnover derived from exempt transactions. Where it is subject to VAT, the interest must be treated as turnover derived from taxed transactions.

VAT relating to rented-out or otherwise provided goods is deductible under the normal rules. Since the rental or any other form of provision of goods to third parties is generally subject to VAT, input VAT borne by those goods is fully deductible.

The rules on determining the amount of deductible input VAT must be applied in respect of each bank individually. Where several banks form part of the same VAT group, the rules can be applied by the individual members of the group, provided that they socially act as separate banks, keep their own financial records and, as regards their business activities, are not integrated with other banks belonging to the same group.

Where deductible input VAT is almost exclusively attributable to a limited number of activities, such as rental of safe deposit boxes or sale of travel arrangements⁹⁰, deduction of input VAT must be based on actual use of the goods and services concerned.

22.3 Actual rate of deduction of input VAT in the financial sector

Statistical information as regards the rate of input VAT recovery for the banking and insurance sectors is not available.

⁹⁰ Sale of travel arrangements and packages of tourist services was an activity of significant importance to banks at the time the Public Notice was published.

23 POLAND

23.1 Legal provisions relating to deduction of input VAT

23.1.1 General overview of exemptions according to the domestic law

Since Poland has joined European Union in May 2004 (the “**Polish VAT Law**”) was entirely re-written in view of the requirements imposed by the Sixth Directive and a new VAT Law was introduced on 11 March 2004. In consequence, a number of the provisions of the Sixth Directive were directly incorporated in the new VAT Law, *inter alia*, the Article 13.B, 17(5) and 19(1).

Strictly speaking Polish VAT Law recognizes only one type of exemption: exemption without the right to deduct input tax. However, certain supplies are subject to the zero rate which is comparable to exemption with the right to deduction. With respect to insurance and financial transactions, a closed list of insurance transactions exempt from VAT is provided by the Attachment nr 4 to the Polish VAT Law, referred to in the Article 43(1)(1) of the Polish VAT Law (see Poland). However, for some financial services⁹¹ a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate directly to export of goods (on condition that entity owns documents proving the relation between the deducted input tax and the specified financial services).

23.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

The Polish VAT Law follows the rulings laid down by the Sixth Directive relating to the deduction of input VAT as regards goods and services used for mixed purposes.

Under the general rule as far as VAT deductibility is concerned (Article 86(1) of Polish VAT Law), a taxpayer is entitled to deduct input VAT from output VAT in so far the goods and services are used for taxable transaction.

The Article 90 of the Polish VAT Law follows closely the provision of the Article 17(5) of the Sixth Directive, under which, as regards goods and services used by a taxpayer for mixed transactions, that is for transactions in respect of which VAT is deductible, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT shall be deductible as is attributable to the former transactions. This proportion is determined as a pro rata participation of the annual turnover from transactions in respect of which VAT is deductible and the total annual turnover from all transactions, both in respect of which VAT is deductible and in respect of which VAT is not deductible. If this pro rata participation represents less than 2% of the total turnover, the taxpayer has no right to the deduction of the input VAT from output VAT. If, however, the pro rata participation represents more than 98% of the total turnover, the taxpayer may fully deduct input VAT from output VAT. Nevertheless it is worth mentioning that the basic method for deduction purposes in the Polish VAT Law when goods and services are used by a taxpayer for mixed transactions is actual use method

According to the Polish VAT Law, it is required to first determine a preliminary pro rata participation in the course of the tax year and subsequently, a final pro rata participation, after the year end.

⁹¹ Namely:

1. Insurance and reinsurance transactions, including services performed by insurance brokers and agents;
2. Granting and managing loans by a person granting it, also via brokerage services;
3. Transactions, also via brokerage services, concerning loans and money assurances and managing the assurances;
4. Transactions, also via brokerage, concerning current and deposit accounts, payments, transfers, debts, cheques and other negotiable instruments, except for factoring and debt collection;
5. Transactions, also via brokerage services, concerning supply of foreign currencies, banknotes and coins used as legal tender, except for collectors' items;
6. Transactions (except for management and safekeeping), also via brokerage services, concerning shares, interests in companies or associations, debentures and other securities, excluding documents establishing title to goods.

The preliminary pro rata participation is calculated on the basis of the annual turnover in the year preceding the tax year for which the pro rata participation is being calculated. For the purpose of the calculation of the pro rata participation, the following transactions are not taken into account in the annual turnover:

1. supply of goods and services included in the taxpayers' fixed and intangible assets, which are subject to amortization*;
2. supply of land and usufruct of the land, if they have been included in fixed assets*;
3. transactions concerning real-estate**;
4. financial brokerage services, excluding**:
 - Pawnbrokers' services, with exemption of those performed by banks;
 - Leasing services;
 - Financial advisory services;
 - Factoring and collecting debts services;
 - Insurance advisory and valuation services for insurance companies, except for services performed by insurance companies themselves;
 - Management of shares, interests in companies or associations, debentures and other securities;
 - Safekeeping of shares, interests in companies or associations, debentures and other securities;
 - Transactions concerning documents establishing title to goods;
 - Transactions concerning rights to real estate.

The preliminary pro rata so determined is rounded up to the first integer number.

The Polish VAT Law provides also for an alternative method of determining the pro rata participation, based on the estimated pro rata agreed upon with the head of the tax office. It is required that the agreed pro rata is documented by a protocol. This alternative method is available, *inter alia*, for the taxpayers for whom the pro rata determined under the general rules would not be representative.

The final pro rata participation is calculated after the end of the tax year, in which the preliminary pro rata participation was done, and is based on the actual input VAT, upon which the taxpayer is obliged to correct the input VAT (Article 91(1) of the Polish VAT Law). However, if the difference between the preliminary and the final pro rata participation does not exceed 2 percentage points, the taxpayer is not required to correct the input VAT. In consequence, the preliminary pro rata participation becomes the final one.

23.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

As regards the right to deduct input VAT in the banking sector, no official administrative guidance was issued.

In this respect, both Ministry of Finance and representatives of private sector were contacted, but apparently no concessions or particular practices were developed in this respect.

* Turnover related to the above mentioned supplies is not included to turnover for the purpose of the calculation of the pro rata, when goods are used for purposes of activity of the taxable person.

** Turnover related to the above mentioned transactions and services is not included to turnover for the purpose of the calculation of the pro rata, when these transactions or services occur occasionally.

23.3 Actual rate of deduction of input VAT in the financial sector

In respect of statistical data as regards the rate of input VAT recovery for banking sector is not available. However based on our investigation the percentage of deductibility should be around 2%.

24 PORTUGAL

24.1 Legal provisions relating to deduction of input VAT

24.1.1 General overview of exemptions according to the domestic law

In line with the Sixth Directive, the *Código do Imposto Sobre o Valor Acrescentado*, Decree-Law n° 394-B/84 of 26 December (the “**Portuguese VAT Code**”) provides for two types of exemptions, namely exemptions without credit and exemptions with credit for previously paid VAT, which relates to the so-called zero-rated transactions. Article 9 of the Portuguese VAT Code provides an extensive list of goods and services exempt without credit, exempts from VAT ordinary banking and other financial transactions (See Portugal).

In certain cases, however, entrepreneurs conducting exempt-without-credit transactions may waive the exemption and become liable for VAT. The option for taxation does not include any of the listed financial services.⁹²

Banking, financial, insurance and reinsurance services supplied from Portugal to persons not established or domiciled in the European Union or where such services are directly linked to goods destined for export to non-EU countries are treated as zero-rated transactions.⁹³

24.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

In principle, no credit can be claimed for input tax paid by the entrepreneur on supplies of goods and services that the entrepreneur subsequently uses in connection with exempt-without-credit transactions or in respect of certain transactions for which a credit is expressly disallowed⁹⁴. A full credit is allowed, for input VAT borne by the entrepreneur on supplies of goods and services subsequently used in connection with zero-rated transactions⁹⁵.

According to Article 23 of the Portuguese VAT Code, a credit is allowed for a pro rata portion of input tax paid by an entrepreneur on purchases of goods and services which the entrepreneur subsequently uses in the course of his business or professional activities for both taxable (including zero-rated) and exempt-without-credit transactions. The amount of this credit is based on the ratio between the entrepreneurs taxable and total turnover during a calendar year, excluding VAT itself⁹⁶.

The specific proportion of deduction is derived from a fraction whose numerator is the annual amount of the supplies of goods and services which give rise to the right to deduct VAT and whose denominator is the annual amount of all the transactions carried out by the taxable person. The latter includes exempt transactions and transactions outside the scope of VAT, provided that they are an economic activity in the sense of the Sixth Directive, particularly grants not subject to VAT other than grants for plant or equipment⁹⁷.

In computing this ratio, however, the turnover attributable to certain transactions is excluded, namely: (i) transfers of fixed assets which have been used in the undertaking’s business; (ii) immovable property transactions that are incidental to the business carried on by the taxable person; and (iii) financial transactions that are incidental to the business carried on by the taxable person.

Since the entrepreneur cannot predict his ratio for the current calendar year will be when it pays VAT, the entrepreneur is required to use, provisionally, the ratio applicable in respect of the previous year. In cases where the use of the ratio applicable in respect of the previous year is not feasible (e.g. new entrepreneurs and entrepreneurs who have substantially altered

⁹² Art. 12, which regulates the waiver of the right to exemption without credit, provides that the following entrepreneurs may waive the exemption: (i) health establishments; (ii) farmers, farming cooperatives and fishermen; (iii) letting, leasing or supplying of immovable property, under certain circumstances and (iv) lessor of immovable property.

⁹³ Art. 20 (1) v).

⁹⁴ Art. 21.

⁹⁵ Art. 20.

⁹⁶ Art. 23(1) reads as follows: Where the taxable person, in the course of his business, makes supplies of goods or services, some of which do not give rise to the right to deduct, input tax shall be deductible only in direct proportion to the annual turnover of the transactions which give rise to the right to deduct.

⁹⁷ Art. 23(4)

their former activities), a provisional ratio must be estimated⁹⁸. In those cases, in the tax return for the last accounting period of the current year, the actual ratio must be determined and, where necessary the credit must be recomputed⁹⁹.

The percentage of input tax allocated to taxable transactions must be rounded up to the upper percentage unit, where it includes decimals¹⁰⁰.

Notwithstanding the pro rata mechanism, the entrepreneur may opt to apply the direct use method¹⁰¹. If this option occur, the General Directorate of Taxes may impose special conditions or prevent its use in cases where it leads to significant VAT distortions¹⁰². The Director General of Taxes may also impose the use of the direct use method on entrepreneurs engaged in different activities or where the application of the pro rata rule leads to significant VAT distortions¹⁰³.

In addition, the Minister of Finance is allowed, for certain activities, to consider as inexistent the operations that give right to the deduction or the ones that do not confer this right, whenever they constitute an insignificant part of the turnover volume and the direct use method is not possible.

24.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

All the general rules outlined above are equally applicable to the financial services sector. There is no further detailed guidance specifically applicable to the financial services sector.

The tax authorities have issued official circulars and private letter opinions clarifying specific aspects of the deduction of input VAT as regards goods and services used for mixed purposes¹⁰⁴. Nevertheless, the Tax Administration opinions addressed specifically to the holding companies had been highly litigated.

It is possible that individual clarifications with respect to application of the rules on deduction of input VAT have been provided to the taxpayers engaged in the financial sector. However, such individual clarifications are not publicly available.

24.3 Actual rate of deduction of input VAT in the financial sector

A formal request was made to retrieve statistical information concerning the deduction of VAT in the financial sector to the Portuguese tax authorities and the Portuguese association of Banks (APB). The APB reverted to their publicly available information, which includes general data on the tax burden on the financial sector, without specifying the deduction of input VAT¹⁰⁵. Up until this moment, no answer was received from the tax authorities concerning the requests.

⁹⁸ Art. 23 (6)

⁹⁹ Art. 23 (7)

¹⁰⁰ Art. 23(8)

¹⁰¹ According to Art 23(2), direct use method means taking the amount of credit, which attaches to purchases of goods and services actually used in his taxable transactions.

¹⁰² Art 23(2)

¹⁰³ Art 23(3)

¹⁰⁴ Ofício-Circulado nr. 17076/86, Ofício-Circulado nr. 79713/89 and Private ruling nr. A090200/2005.

¹⁰⁵ See http://www.apb.pt/NR/ronlyres/BDB7FD3A-80CA-418B-B5B1-613DA1596934/0/BoletimInformativoN_38.pdf

25 ROMANIA

25.1 Legal provisions relating to deduction of input VAT

25.1.1 General overview of exemptions according to the domestic law

The main provisions concerning VAT deduction are contained in the Law No. 571/2003, as subsequently amended (the “**Romanian Tax Code**”).

Pursuant to Art 145 Chapter 10 of the Tax Code, input VAT may be deducted by VAT payers. To note, VAT payers who have been registered only due to acquisition of goods from other Member States but do not perform any economical activity are not entitled to VAT deduction. However, these and other persons may deduct VAT in respect of supply of new transport vehicles to other Member States.

The general principle governing VAT deduction is set in Art 145 of the Tax Code, while the conditions for exercising the right to deduct are set under Art. 146. Article 145 provides that a VAT payer may deduct VAT for acquired or imported goods and services, if these goods and services are designated to be used for supply of VAT taxable goods and services by that VAT payer. VAT may also be deducted for goods and services used in activities carried on abroad, if such activities give right to deduction when carried on the Romanian territory. Exemptions with regard to financial and insurance services are provided in article 141 of the Romanian VAT Act (see Romania).

25.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

“Direct use” criterion

Art 147 of the Romanian VAT Code provides that a VAT payer who is engaged in mixed activities (i.e. where some of the activities are VAT taxable and the other ones are not) shall apportion input VAT to each type of the activities, depending on what activities goods and services are to be used for. There must be a direct link between goods and services in respect of which VAT is deducted and the activity of a VAT payer giving rise to VAT deduction.

Pro rata criterion

According to Art 147 point 5 of the Romanian Tax Code, if it is impossible to attribute directly the input VAT to a particular activity, it shall be apportioned proportionally. Thus, the direct use criterion is prevailing but a part of input VAT which cannot be apportioned on a direct use basis shall be pro rata divided into deductible and non-deductible portions.

The pro rata formula is that a percentage of input VAT which is attributable to VAT taxable activities (and therefore deductible) must correspond to the portion of income from VAT taxable supplies (VAT excluded) in the total income (VAT excluded) of a VAT payer. The percentage must be rounded up to whole figures.

According to Art 147 point 7 of the Romanian Tax Code for the purposes of calculating the pro-rata portion of deductible VAT, the following types of income are ignored:

- (i) the income from the supply of fixed assets used in the activities of a VAT payer;
- (ii) transfer of goods or render of services to its own activity, under certain conditions;
- (iii) the income from supply of immovable property and financial services, if these transactions are occasional and a VAT payer is not regularly engaged in such activities.

When calculating this proportion the amount of received and consumed subsidies shall be added to the total income.

The “total income” (as denominator in the pro rata formula) does not include received dividends or any other income from shares, as well as income from holding of securities, income from bank deposits, bank accounts or bank cards, extraordinary gains, and similar receivables which are not “income from activity”.

When calculating the portion of deductible VAT, results of the previous calendar year shall be used. Pro rata should be notified to the tax office by the 25th of January of the year. If such results are not available, then forecasts made by the VAT payer shall be used. In this case the pro rata should be notified to the tax office by the due date of the first VAT return for the first year of application. The portion must be used the whole year. After the end of a calendar year the deductible VAT portion is subject to adjustment according to the actual results of that year.

Other VAT adjustments

The Romanian Tax Code provides for the possibility to make adjustments to the VAT subject to other criteria than the direct use or the pro rata deduction.

Art 149 of the Romanian Tax Code provides that if a portion of input VAT attributable to the VAT taxable activity according to the pro rata criterion does not reflect the real use of assets, or there are changes in the elements took into consideration when computing the pro rata, he must adjust the deductible VAT.

The VAT adjustments may occur especially in relation with fixed assets, owned or leased, as well as any operation regarding fixing, maintaining or up-grading such assets, which are totally or partially used for other activities than its business, for activities without the right to deduct VAT or for activities which allows the right to deduct VAT at a lower value.

The local tax administrator may compel a VAT payer which apportionment criterion shall be used in respect of particular goods or services. This is the case when the immovable property is used in mixed activities and the deductible VAT portion established on pro rata basis unreasonably gives a substantial advantage to a VAT payer. The local tax administrator may instruct a VAT payer to apply the apportionment criterion which realistically reflects the use of goods and services. If a VAT payer disagrees with such an instruction, he may appeal the decision of the tax administrator under the general procedure.

25.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no special rules or publicly available practice concerning the VAT deduction for financial service and insurance sectors.

25.3 Actual rate of deduction of input VAT in the financial sector

Information on national average pro-rata recovery rates for financial service and insurance sectors is not publicly available.

26 SLOVAK REPUBLIC

26.1 Legal provisions relating to deduction of input VAT

26.1.1 General overview of exemptions according to the domestic law

In line with the provisions of the Sixth Directive, pursuant to **Slovak VAT Act** (N. 222/2004 Coll.) the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, financial banking and insurance transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

A list of the financial services is provided in Slovak Republic.

26.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

In principle, pursuant to Section 49 (1) and (2) of Slovak VAT Act input VAT is deductible the taxpayer uses the taxable supplies (goods and services) received for its business purposes. Whilst, Section 49 (3) contains the principle that the taxpayer cannot deduct the tax that he will use for the supply of goods and services that are tax exempt. In this respect Section 49(4) contains the principle of partial deductions:

- if a taxpayer uses the goods and services for supplying goods and services that qualify for the tax deduction and, at the same time, for supplying goods and services that do not qualify for the deduction, he shall be obliged to apply the procedure specified below when calculating the deductible proportion of the tax.

Pursuant to Article 50 of Slovak VAT Act, the taxpayer shall calculate the proportion deductible as a multiple of the VAT and a coefficient, rounded up to two decimal places.

The coefficient shall be calculated as a fraction of:

- as **numerator**: the revenues on goods and services for a calendar year, on which the tax is deductible,
- as **denominator**: the revenues on all goods and services for the calendar year.

In calculating the coefficient, neither the numerator nor the denominator include revenues (incomes) from:

- a) the sale of business or a part of it constituting an independent branch;
- b) the sale of assets used by the taxpayer for the purpose of his business, excluding inventories;
- c) financial services that are tax exempt, if they were provided by the taxpayer on an occasional basis;
- d) the incidental transfer of immovable assets and incidental lease of immovable property;
- e) the sale of returnable bottles, except for those that are sold from this country to another Member State or that are imported to the territory of a third country.

26.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

As regards the right to deduct input VAT in the banking sector, no official administrative guidance was issued.

In this respect, both Ministry of Finance and representatives of private sector were contacted, but apparently no concessions or particular practices were developed in this respect.

26.3 Actual rate of deduction of input VAT in the financial sector

In respect of statistical information as regards the rate of input VAT recovery for banking sector is not available neither at the Ministry of Finance nor neither in the private sector.

27 SLOVENIA

27.1 Legal provisions relating to deduction of input VAT

27.1.1 General overview of exemptions according to the domestic law

In Slovenia VAT was introduced in July 1999. Since Slovenia became part of the European Union, Slovenian Parliament has adopted changes and amendments to the Value Added Tax Act (the "**Slovenian VAT Act**"), which became effective on the May 1st 2004. VAT framework was already in line with the Sixth Directive, so in 2004 the VAT system has not changed significantly – new rules were introduced in the field of intra-community supplies of goods and services.

In November 2006 new Slovenian VAT Act¹⁰⁶ was adopted, which will become effective in January 2007. The new Slovenian VAT Act does not derogate from the previous one, it has just introduced more detailed rules which are implemented in the Sixth Directive. In this report legal provisions of the new VAT Act are presented

27.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

The scope of the right to deduction of input VAT under Slovenian VAT Act is in practice generally the same as that under the Sixth Directive. According to Article 63 of the Slovenian VAT Act a taxable person is entitled to deduct from its tax liability input VAT due or paid in respect of purchases of goods or services provided, if it used or will use such goods or services for the purposes of his taxable transactions.

Furthermore, taxable person is also entitled to deduct input VAT in so far as the goods and services are used for the purposes of:

- a) economic activities (Article 5 (2) of Slovenian VAT Act) carried out outside Slovenia, which would be deductible if they had been performed in Slovenia,
- b) transactions which are exempt pursuant to Articles 46, 49, 50 (13), 52 – 58 of Slovenian VAT Act (intra-community supplies, supply of services in connection to importation of goods, exports and supplies of goods and services linked to international goods traffic (supplies under custom arrangements) – exempt supplies with the right to deduction),
- c) transactions exempt in accordance with Article 44 (1), (4) (a) to (e) (insurance and financial transactions) if the customer is established outside the Community or if those transactions are directly linked to goods intended for export to a country outside the Community.

VAT incurred on goods and services which are used by a taxable person for both taxable and exempt or non-business activities may be deducted to the extent that it is attributable to taxable activities (transactions covered by Article 63 of Slovenian VAT Act). Based on that, exempt supplies with no right to deduction affect the amount of deductible input VAT.

According to Article 65 of Slovenian VAT Act and Article 103 of the Regulations on the implementation of the VAT Act (Regulations) a taxable person who also performs those exempt supplies has 3 options for deduction of input VAT based on:

- criterion of direct use, if a taxable person provides in his bookkeeping or non-bookkeeping records data of the input VAT and the amount of input VAT for which he is entitled to deduct input VAT (a taxable person must keep separate records for both, taxable and exempt activities);
- the calculation of one deductible proportion for all activities performed by taxable person according to Article 65 (2) of the Slovenian VAT Act;
- the calculation of deductible proportion for each sector of taxable person's business according to Article 65 (7) (a taxable person must keep separate records for each sector).

¹⁰⁶ Value Added Tax Act, Official Gazette RS 117/2006.

In case of pro rata deductible proportion of VAT (items 2 and 3 above) must be determined for the total supply of goods or services, having:

- (a) as a **numerator**: the total amount of annual turnover attributable to transactions in respect of which VAT is deductible under Article 63
- (b) as a **denominator**: the total amount of annual turnover attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible, including subsidies, other than those specified in Article 36 (1), which are directly linked to the price of supplies of goods or services (of business or a sector of the business).

A taxable person who only performs taxable activities, but receives payments, which are not considered as payments for supplied goods or performed services (endowment), does not calculate the deductible proportion.

The proportion must be determined on an annual basis, fixed as a percentage and rounded up to an integer value.

The provisional proportion for a current year must be calculated on the basis of the previous year's transactions. In the absence of any such transactions in the preceding year, or where they were insignificant, the provisional deductible proportion must be determined by the tax authority on the basis of the taxable person's own forecasts. Deductions made on the basis of provisional proportions must be adjusted when the actual proportion is calculated during the next year (usually in VAT return for February of the current year for the previous year).

Following items should be excluded from the calculation of the deductible proportion:

1. the amount of turnover attributable to supplies of capital goods used by taxable person for the purposes of his business,
2. the amount of turnover attributable to incidental real estate transactions,
3. the amount of turnover attributable to incidental financial transactions.

Detailed rules concerning the calculation of the deductible proportion are defined in the Regulations. Article 101 of the Regulations on the implementation of the Slovenian VAT Act defines that financial transactions are deemed to be incidental, if financial transactions are not considered as the business activity of a taxable person. Also yields on securities (dividends, interests, capital gains) and the amounts of the deposits, which are not the subject to VAT, must be excluded from the calculation of the deductible proportion.

As mentioned above a taxable person may determine the deductible proportion for each sector of his activity separately, when he keeps separate records for each sector of his activity and he notifies the tax authorities on the method of defining the deductible proportion. If the tax authority receives the notification at least 15 days before the start of the new tax period, the taxable person may start to calculate the deductible proportions for each sector of his activity in the first tax period following the tax period in which he informed the tax authority about his decision, otherwise with the beginning of the next tax period. The taxable person must calculate a deductible proportions for each sector of his activity for at least 12 months. If a taxable person wishes to change the method of calculating the deductible proportion again, he must notify this change to the tax authority.

The tax authority may, following the notification made in accordance with the previous paragraph, prohibit the taxable person from using the chosen method for determining a deductible proportion if a taxable person has chosen a method which does not enable the implementation of the legally defined supervision of the calculation and payment of the VAT.

An initial deduction of input VAT must be properly corrected according to Article 68 of VAT Act:

1. if the deduction was higher or lower than the amount to which a taxable person has been entitled;
2. if after the tax return is made, some change occurs in factors used to determine the amount of VAT to be deducted, e.g., cancellation of purchases and price reductions.

However the adjustments are not made in cases where destruction or loss of the property is

duly proved or confirmed and in the case of use for the purpose of making gifts of small value (20 EUR) and producing samples.

According to Article 69 of Slovenian VAT Act in case of capital goods, adjustments are spread over five years. For immovable property acquired as capital goods, the period of twenty years instead of five years is applicable.

The period of 5 or 20 years is calculated as of the tax period in which the deduction of input VAT was (or was not) made.

The annual adjustment can be made only in respect of 1/5 or 1/20 of the VAT charged for the goods. The adjustment must be made on the basis of the variations of taxable status in subsequent years in relation to that for the year in which the goods were first used (acquired or manufactured).

The adjustment of input VAT should not be made if the difference does not exceed 10 EUR.

If capital goods are sold during the period of adjustment they are deemed used for business purposes by the taxable person until the end of the period of adjustment. Such business activities are fully taxed if the supply of the said goods is taxable and exempt if the supply of goods is exempt (e.g. sale of immovable property). The adjustment for the remaining period must be made only once for the whole period of adjustment still to be covered.

The amount of adjustment of input VAT is determined as follows:

$$\frac{\text{input VAT x changed pro rata in percent}}{\text{period of adjustment of input VAT (in year)}}$$

Detailed rules concerning the taxation of financial services are defined in the Regulations.

27.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

According to Slovenian legal system the opinions of Ministry of finance or Tax authorities are not legally binding for taxable persons (based on the Provision of the new Tax Procedure Act the opinions of above mentioned authorities are after 1 January 2006 legally binding only for tax authorities). Therefore only Provisions of Acts and Regulations may be used in tax affairs.

In 2006 Tax authority or the Ministry of Finance did not issued any recommendations or explanatory notes that would effect the existing provisions regarding deductions of input VAT based on the deductible proportion.

27.3 Actual rate of deduction of input VAT in the financial sector

The Ministry of Finance does not collect any statistical information about national pro rata recovery rates.

Based on the information provided to us by some of the biggest Slovenian financial companies (banks, insurance companies, brokerage companies and other financial institutions – 28 companies were included in the survey, which presents approximately 30 percent of the respective market share), we may present the pro rata rates according to available data of those companies. Most of them are not able to deduct any input VAT since they do not provide any taxable supplies (pro rata is 0 percent) or have decided not to deduct minimal input VAT (usually in cases of 1 percent pro rata) in order to avoid administrative burden (19 companies). The pro rata recovery rate for financial institutions in general varies between 0 and 5 percent

28 SPAIN

28.1 Legal provisions relating to deduction of input VAT

28.1.1 General overview of exemptions according to the domestic law

In line with the Sixth Directive, the *Impuesto sobre el Valor Añadido*, Law 30/1985 of 2 August (the “**Spanish VAT Code**”) provides for two types of exemptions, namely exemptions without credit and exemptions with credit for previously paid VAT, which relates to the so-called zero-rated transactions. In particular, Article 20 of Spanish VAT Code, provides an extensive list of insurance and financial transactions belonging to the former category and therefore do not entitle the entrepreneur to deduct the input VAT (See Spain). However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

28.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

VAT payers are generally entitled to deduct from the amounts of VAT charged on taxable transactions carried out by them the amounts of input VAT, insofar as the goods and services acquired are used by them to carry out transactions which confer the right to deduct input VAT. However, input VAT borne on goods or services which are not used directly and exclusively for business or professional purposes is not generally deductible, although some exceptions apply to capital goods (partial deduction). The right for such deduction is also conditional upon formal requirements and it may be exercised in a period of four years.

There are several apportionment regimes.

General “pro rata” (deductible proportion) rule. Article 104 Spanish VAT Act

This rule applies when the VAT payer makes both supplies of goods or services giving rise to the right to deduct and other transactions which do not give rise to such right (e.g. exempt financial transactions). In such case, the VAT paid in each tax period is deductible in the proportion which determines a percentage of deductible VAT. This percentage, which is finally rounded up, is calculated by application of the following:

- As the **numerator**, the total amount, determined for each calendar year, of the supplies of goods and services giving the right to deduct made by the taxable person in the course of his business or professional activity or, as the case may be, in the relevant sector of business.
- As the **denominator**, the total amount, determined for the same period of time, of supplies of goods and services made by the taxable person in the course of his business or professional activity or, as the case may be, in the relevant sector of business, including those which do not give the right to deduct.

In the case of tax-exempt transactions involving the transfer of foreign currency, bank notes and coins that are legal means of payment, the amount to be included in the denominator shall be the consideration from the resale of such legal means of payment plus any commission received less the acquisition price of such legal means of payment.

In transactions involving transfers of promissory notes and securities that are not part of the portfolio of a financial institution, the amount to be included in the denominator shall be the consideration from the resale of such instruments plus any interest and commission due and payable less the acquisition price of such instruments. In the case of securities that are part of the portfolio of a financial institution, the proportional amount of interest due and payable during the period in question and any capital gains on the transfer of the securities concerned, shall be included in the denominator.

When determining the deductible proportion, among other transactions, it shall not be included in either of the parts of the fraction:

- financial transactions, including those which do not qualify for exemption, that are not part of the habitual business or professional activity of the taxable person;
- the amount of supplies and exports of any capital goods used by the taxable person for the purposes of his business or professional activity as there are special rules

relating to adjustments of the input VAT which has initially been deducted in respect of capital assets. Those adjustments must be made in the four and nine years, respectively, following the year in which the assets were taken into use. The annual adjustments must be made at the end of each financial year on the basis of the rate of recovery of input VAT applicable to the acquisition year, unless the difference between such percentages of deduction does not exceed 10%; and

- transactions performed from fixed establishments situated outside the territory where the tax applies, where the costs relating to such transactions are not borne in Spain. In the case of services supplied outside the Spanish territory, the amount of the transaction shall be the result of multiplying the total consideration by the coefficient obtained by dividing the portion of the cost borne in Spain by the total cost of the transaction, not computing the cost of personnel employed.

The special “pro rata” (deductible proportion) rule (Article 106 Spanish VAT Act)

The right to deduct under the special deductible proportion procedure may be exercised when the VAT payer opts to do so (this option has to be normally exercised within the month of December prior to the tax year in which it will apply). In such case, the following rules apply:

- VAT paid on acquisitions or imports of goods and services used exclusively for transactions giving the right to deduct may be deducted in full.
- VAT paid on acquisitions or imports of goods and services used exclusively for transactions not giving the right to deduct cannot be deducted.
- VAT paid on acquisitions or imports of goods and services used only partly for transactions giving the right to deduct, may be deducted in the proportion resulting from the application of the general pro rata rule.

The special pro rata rule will be mandatory when the total amount of tax deductible in a calendar year under the general deductible proportion rule exceeds by 20% that which would have been deductible under the special deductible proportion rule.

Deduction system for different sectors of business or professional activity (Article 101)

When the VAT payer carries on different business activities, it has to apply the corresponding deduction rules separately to each activity.

Business activities are considered to be “different” when they are classed in different groups in the National Classification of Economic Activities and they have different applicable rules for deduction (amongst others, this requisite is understood to be met when their deductible proportions, calculated in accordance with the general pro rata rule, differ by more than 50 percentage points).

Thus, the VAT payer has to apply either the general “pro rata” rule or the special pro rata rule as described above in each of its sectors of activity. VAT paid on acquisitions or imports of goods and services used in both activities may be deducted in the proportion resulting from the application of the general pro rata rule.

For these purposes, leasing activities and receivable supplies excluding those performed under a factoring contract are legally classified as independent sectors of business activities.

28.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

No concessional practices that we are aware of is available.

28.3 Actual rate of deduction of input VAT in the financial sector

In respect of statistical information as regards the rate of input VAT recovery for banking sector is not available neither at the Ministry of Finance nor neither in the private sector.

29 SWEDEN

29.1 Legal provisions relating to deduction of input VAT

29.1.1 General overview of exemptions according to the domestic law

The Swedish Value Added Tax Act (*Mervärdeskattelagen* 1994:200, the “**Swedish VAT Act**”) was revised to comply with EC law, before Sweden’s accession to the European Union on 1 January 1995. The revised Swedish VAT Act entered into force as from 1 July 1994. Generally, it should be noted that the exact wording of the Sixth Directive has not been incorporated into the legislation and there are many derogations.

In line with the provisions of the Sixth Directive, the exemptions are divided into exemptions without right to deduction and exemptions with right to deduction. In general, *inter alia*, financial and insurance transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if supplied to an entity located outside the European Union or if they relate to export.

In particular Swedish VAT Act exempt bank and financial services and trade in securities or such similar businesses (Ch. 3, Sec. 9(1) ML) and insurance and re-insurance services transactions (Ch. 3, Sec. 10, ML) from VAT. The provisions correspond to Article 13B(a) and (d) of the Sixth Directive.

With regard to Ch. 3 Sec, 9 ML, in Sweden, there is no concept of bank and financial services. Accordingly, no extensive list of exempt banking services exists. However, Ch. 3, Sec. 9(2) ML contain a negative list according to which the following services are not considered bank and financial services;

- Specially defined administrative services (*notarietjänster*);
- Debt collection (*inkassotjänster*);
- Administrative services regarding factoring; and
- Rent of deposit (storage) facilities (*uthyrning av förvaringsutrymmen*)¹⁰⁷.

Guidance on which bank and financial services that are covered by the exemption can be found in the Swedish Tax Authorities Guideline on Value Added Taxation 2006 (the “**VAT Guideline**”) according to which, traditional bank services such as interest on loans, bank guaranties, loan administrative services, payment services are treated as financial services¹⁰⁸.

On 8 June 2006, the Swedish Bankers Association submitted a Consultation Paper on modernizing Value Added Tax obligations for financial and insurance services to the Commission, pointing out e.g. that it is unclear what constitutes bank or financial services under domestic law. Consequently, specialists or all parties that do not practice in the transfer of rights and obligations regarding financial instruments, but perform other, often essential services in order for a transaction to take place, run the risk of being liable to VAT¹⁰⁹. For example, the brokering of units in investment funds has been deemed taxable services of the Swedish Administrative Supreme court¹¹⁰ and by the Swedish Tax Authorities. It is the view of the Swedish Bankers Association that the exemption on bank and financial services is not sufficiently clear and therefore not compatible with EC law and in particular the Sixth Directive.

Furthermore, under Ch. 3, Sec. 9 (3) ML, securities trading transactions and management of investment funds covered by Law 2004:46 on Investment funds are exempt¹¹¹. The exemption corresponds to Article 13B(d) (3, 5 and 6) of the Sixth Directive¹¹².

¹⁰⁷ Ch. 3, Sec. 9(2) ML.

¹⁰⁸ Swedish Tax Authorities Guidelines on Value Added Taxation 2006, p. 986-991.

¹⁰⁹ Consultation comments – “Consultation Paper on modernizing Value Added Tax obligations for financial services and insurances”, Swedish Banker’s Association, Swedish Securities Dealers Association, Swedish Investment Fund Association, p.2.

¹¹⁰ RÅ 2005, note 61.

¹¹¹ Ch. 3, Sec 9(3) ML.

¹¹² Swedish Tax Authorities Guidelines on Value Added Taxation 2006, p. 991.

Under Ch. 3, Sec 10 ML, insurance and re-insurance services transactions are exempt from VAT. Exemption for services rendered by insurance companies not constituting insurance services will be determined on a case-by-case basis taking into account domestic and ECJ case law¹¹³. For example, the Swedish Administrative Supreme Court has held that an insurance company's obligation to operate and administer insurance activities of another insurance company, constitute operation and administration services and not insurance services as exempt under Ch. 3, Sec 10 ML¹¹⁴. The Court held that the insurance activities of the other company were not performed directly by the operating insurance company. According to later case law from the ECJ similar type of insurance service transactions shall not be covered by above exemption. In case C-240/99 Skandia, ECJ held that an insurance company's obligation to operate and administer insurance activities of another insurance company and therefore receiving remuneration at market value, that continues to conclude insurance contracts in its own name, was not an insurance service transaction covered by Article 13 B(a) Sixth Directive.

29.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

Under the main rule regulating deduction of input VAT, full deduction is permitted for input VAT paid that relates to acquisitions for the portion of the activity that entails tax liability. However, no deduction right exists for acquisitions for the portion of the activity that does not entail tax liability¹¹⁵. For acquisitions to be used or consumed in both lines of business (joint acquisitions), VAT paid must be divided on reasonable grounds. Reasons for this division may, for example, be the ratio between the taxable and the total turnover, or how the area of the premises is used¹¹⁶.

Deductibility of input VAT is limited to VAT paid for activities attributable to taxable business activities including business activities that give right to recovery of input VAT¹¹⁷. The supply of banking, financial, insurance and reinsurance services from Sweden to non-EU countries gives the right to refund even if exempt under domestic provisions¹¹⁸.

In Sweden, a person subject to VAT, who supplies both taxable and exempt goods or services, is known as a partially exempt person (i.e. the person supplies mixed transactions). VAT in respect of such transactions is recovered on the basis set out under the domestic deduction rules. These rules are found under Ch. 8, Sec. 13 and 14 ML.

With regard to mixed transactions domestic law explicitly states that, if it cannot be determined if a certain acquisition is attributable to the taxable activities or the non-taxable activities, the deduction for input VAT should be determined on reasonable grounds¹¹⁹.

The allocation of the credit between the taxable and exempt transactions is usually made on the basis of the respective proportion of sales in each category. Other methods of allocation, e.g. on the basis of the wages paid for activities in each category, time spent etc, are also permitted.

VAT paid on joint acquisitions, which are attributable by more than 95% to the part of the business, which is taxable for VAT, may be deducted without being apportioned on reasonable grounds¹²⁰.

If tax liability incurred is more than 95% of the total turnover of the business, VAT paid which does not exceed SEK 1,000 in respect of a particular acquisition may be deducted without being apportioned on reasonable grounds¹²¹.

¹¹³ Swedish Tax Authorities Guidelines on Value Added Taxation 2006, p. 998.

¹¹⁴ RÅ 1997, ref 42.

¹¹⁵ Ch. 8, Sec. 3 ML.

¹¹⁶ Swedish Tax Authorities Guidelines on Value Added Taxation 2006, p. 461.

¹¹⁷ Ch. 10, Sec. 9-12 ML and Swedish Tax Authorities Guidelines on Value Added Taxation 2006, p. 459.

¹¹⁸ Ch. 10, Sec. 11(2) ML.

¹¹⁹ Ch. 8, Sec. 13(1) ML.

¹²⁰ Ch. 8 Sec, 14 (1)(1) ML.

¹²¹ Ch. 8 Sec, 14 (1)(2) ML.

29.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

In Sweden, there are no specific administrative notices with regard to the right to deduct input VAT in the financial sector. In practice, the VAT Guideline, gives further guidance on the rules relating to deduction of input VAT in the financial sector. The VAT Guideline is published on a yearly basis, addressing general domestic and international VAT tax questions. These guidelines are not binding on the Tax Authorities or the taxpayers. Rather, their main purpose is to provide guidance for a consistent application of the VAT rules. In practice this is an important tool for guidance for both tax authorities and taxpayers.

Except from two cases decided by the Regional Administrative Court (*Länsrätten*) there is little guidance on determining which allocation grounds that have been accepted by the Court determining which amount of input VAT is deductible, i.e. what constitute reasonable grounds under Ch. 8, Sec. 13 ML.

In Case no. 2580-04, 2582-04 a company used the time spent by its employees working on different services as allocation bases for the deduction of input VAT. This was accepted by the Court as allocation made on reasonable grounds¹²².

Generally Sweden applies a direct attribution system. In some cases the pro rata method in Article 19(1) has been applied.

29.3 Actual rate of deduction of input VAT in the financial sector

There is no statistical information with regard to the rate of input VAT recovery in Sweden. Generally, the recovery rate is low since financial services and insurance transactions are exempt.

¹²² Regional Administrative Court of Stockholm, Case no. 2580-04, 2582-04.

30 UK

30.1 Legal provisions relating to deduction of input VAT

30.1.1 General overview of exemptions according to the domestic law

The Value Added Tax Act 1994 (the "UK VATA"), and its supporting schedules, is the basis of VAT legislation in the United Kingdom. It is supported by secondary legislation in the form of Statutory Instruments (SIs) comprising orders and regulations. Most of the main VAT regulations are found in the Value Added Tax Regulations 1995 (SI No. 2518/2006) ("VAT Regs"), including regulations 99 to 111, which concern input VAT and partial exemption.

Exemptions from VAT are contained in Section 31 and Schedule 9 of the UK VATA. Exemptions with regard to financial and insurance services are provided in Schedule 9, Groups 2 and 5 (see UK).

In line with the provisions of the VAT Directive, the exemptions are divided into exemptions without the right to deduct and exemptions with the right to deduct. In general, *inter alia*, financial and insurance transactions belong to the former category and therefore do not entitle the entrepreneur to deduct the input VAT. However, a right to deduct the input VAT is provided if financial or insurance services are supplied to an entity located outside the European Union or if they relate to an export.

30.1.2 Deduction of input tax in respect of goods and services used for mixed purposes

The rules regarding deduction of input VAT are covered by Sections 25 and 26 of the VATA.

Section 26(2) lists those supplies which carry a right to deduct:

- Taxed supplies;
- Supplies made outside the UK that would have been taxed had they been made in the UK; and
- Any other supply that the UK Finance Ministry has specified by order.

Specified supplies are:

- financial services supplied to persons belonging outside the member states or directly related to an export of goods;
- insurance services supplied to persons belonging outside the member states or directly related to an export of goods; and
- supplies of investment gold.

It is a fundamental principle that deduction is only allowed to the extent the goods or services purchased are used to make supplies with the right to deduct. Therefore, input VAT attributable to exempt supplies is not normally deductible.

Small amounts of input VAT relating to exempt supplies can be ignored according to defined *de minimis* limits. The limit applies where the value of exempt input tax amounts to no more than £ 625 (€940) per month on average, and exceeds no more than one half of all the input VAT for the period concerned (Regulation 106).

A taxable person who supplies goods and services, only some of which carry a right of deduction, is partly exempt. Input VAT is first recovered on the basis known as direct attribution. This means input tax must be directly attributed to each liability of supply, and recovered, according to where there is a right to deduct, as far as is possible. The residual element - that which cannot be directly attributable - must be apportioned. The normal method of apportionment is to use the ratio of taxed supplies to all supplies in the relevant tax period. This is known as the "standard pro rata method" of apportionment:

$$\frac{\text{value of taxed supplies}}{\text{value of all supplies}} \times \text{non-attributable input tax}$$

Under the standard method the result is expressed as a percentage and may be rounded up to the next whole number.

In UK law, amounts of turnover attributable to incidental supplies of finance and real estate are excluded from any pro rata method by regulations 101(3)(b) and 102(2).

The standard method can be used without prior approval by the UK Tax Authority, however, it is normally only suitable for small or medium sized businesses and not for businesses in the finance and insurance sector.

If the standard method does not produce a fair and reasonable result, taxable persons may seek approval from the UK Tax Authority to use a "special method". Most large businesses and businesses in the finance and insurance sector, operate a special method. The special method to be used will often depend on the nature of the business activity. Examples of special methods include:

- the number of staff used for making supplies with the right to deduct expressed as a percentage of the total number of staff;
- the number of taxable transactions made and/or received expressed as a percentage of the number of total transactions made and/or received;
- the area of a building used for the purposes of making taxable transactions expressed as a percentage of the total area of the building.

Special methods for large businesses (especially for large finance and insurance businesses) often comprise separate apportionment calculations for different parts of the business called sectors. For example, a high-street bank that also made supplies of leasing and asset-finance would have different apportionment calculations for each sector. In these cases, the special method would firstly allocate input VAT to the various sectors (often using management accounting rules), and then apportion the input VAT in each sector between supplies with the right to deduct and supplies without the right to deduct using an appropriate pro-rata calculation. Apportionment under a special method could be based on any calculation, for example one of those in the preceding paragraph or a pro-rata calculation using the output values of that sector. The calculations in special methods are typically determined to two decimal places.

Whichever method is used, it must be supported by objective documentary evidence, meet the conditions of the legislation and, if it is a special method, written approval must be given.

In exceptional circumstances, the UK Tax Authority can direct the use of a particular method (Regulation 102, VAT Regs).

The UK Tax Authority has the power to override the use of a standard pro rata or special method.

The standard method is automatically overridden where it fails to secure a fair and reasonable result when compared to the actual use of VAT bearing costs. This override applies only to taxpayers whose residual input VAT exceeds £50,000 p.a (€75,000). or, where the taxpayer is a group, exceeds £25,000 p.a (€37,500). The override requires an adjustment to be made where the result of the standard method differs substantially from one which reflects actual use; this is deemed to occur where the difference in deductible VAT as a result of apportionment exceeds (a) £50,000 (€75,000) or (b) both 50% of residual input VAT and £24,999 (€37,499). The adjustment can be calculated by any other method provided that it produces a fair and reasonable result.

The special method override applies where the special pro rata method used by the taxpayer does not produce a fair and reasonable result. Unlike the standard method override, the special method override is not automatic, and only applies if the UK Tax Authority requires, or if the taxpayer requests it and the UK Tax Authority approves. If a special method override (called a Notice) is in place, then the taxpayer is required to calculate the adjustment required to correct the position. In contrast to the standard pro rata method override, there is no threshold limit for adjustment.

All partly exempt persons normally have to carry out an annual adjustment calculation at the end of each tax year to smooth fluctuations in the deductible percentage arising from one tax period to the next. The adjustment establishes the total amount of recoverable residual input VAT that may be recovered for the past 12 months. VAT may therefore be paid to the UK Tax Authority or repaid by them, following the adjustment (Regulation 107).

A special scheme exists, known as the Capital Goods Scheme, which requires further annual adjustments to the input VAT on certain capital items over their useful life to reflect fluctuations in their use in making taxed supplies (Regulations 112 to 116, VAT Regs). The scheme applies to individual items of computer hardware costing at least £50,000 (€75,000) (excluding VAT), and to certain acquisitions of and work on commercial property costing at least £ 250,000 (€375,000) (excluding VAT). Under the rules of the scheme, adjustment to the initial amounts of input tax recovered must be made each following VAT year (interval) throughout the adjustment period applicable to the capital item. The adjustment is based on the extent to which the capital item is used in making supplies with the right to deduct and supplies without the right to deduct in each interval. The period of the adjustment is five successive intervals in respect of computers and short leases (i.e. the lease has less than 10 years to run); and ten successive intervals in respect of other land and buildings (Regulation 114).

Further changes to the partial exemption rules were announced in the 2006 UK Budget. Businesses will be required to declare that their proposed special method 'to the best of its knowledge and belief' is fair and reasonable. The tax authorities will have the power to set aside a method if the person signing the declaration knew or ought reasonably to have known that is not fair and reasonable. The business would then have to recalculate past returns to ensure that it only recovered a fair and reasonable amount of VAT. This change is expected to take effect from 1 April 2007.

30.2 Special legislation or administrative practices relating to deduction of input VAT in the financial sector

There are no regulations specific to the financial services sector. The calculation of deductible input VAT by businesses in this sector must follow the general rules outlined above. The guidance issued by the UK Tax Authority states that the "standard pro rata method" is not an acceptable method for use by financial institutions. The guidance sanctions the use of non-turnover based methods (e.g. based on numbers of staff or transactions) but does not suggest that any particular method will be acceptable.

Although the UK Tax Authority no longer has set agreements with the finance sector, there is published UK Tax Authority guidance on partial exemption methods.

There is one extant agreement with a finance trade body, the Association of British Factors and Discounters (ABFD).

Factors are required to identify separately the input VAT incurred in relation to invoice discounting and mainline factoring. Invoice discounting businesses must negotiate an appropriate special method with the UK Tax Authority on a case by case basis. Mainline factoring businesses determine deductible input tax based on transaction counts using the following calculation:

Taxed transactions / Taxed and exempt transactions x Input tax relating to the mainline factoring business sector

For the purpose of this calculation taxed transactions comprise invoices, credit notes, debtor payments and payments to clients at maturity, and exempt transactions comprise prepayments to clients and interest.

30.3 Actual rate of deduction of input VAT in the financial sector

The UK Tax Authority has not published any information regarding input tax recovery rates for financial sector businesses. Information relating to taxpayers' affairs may only be disclosed in prescribed circumstances authorised by legislation.

ANNEX

AUSTRIA

Financial and insurance services exempt pursuant to Sec. 6(1)(8) of the VATA

1. Granting and negotiation of credit (Sec. 6(1)(8)(a) of the VAT Act)
2. Supply and negotiation of legal tender (Sec. 6(1)(8)(b) of the VAT Act)
3. Monetary claims and debentures (Sec. 6(1)(8)(c) of the VAT Act)
4. Turnover derived from transactions concerning deposit and current accounts, payments, transfers and the collection of commercial papers (Sec. 6(1)(8)(e) of the VAT Act);
5. Securities (Sec. 6(1)(8)(f) of the VAT Act)
6. Transfer of shares (Sec. 6(1)(8)(g) of the VAT Act)
7. Taking over of liabilities (Sec. 6(1)(8)(h) of the VAT Act)

BELGIUM

The Belgian VAT Code provides for the following exemptions with respect to financial and insurance services:

1. insurance and re-insurance transactions including services related thereto performed by insurance brokers and insurance agents, except where they act as loss adjusters¹²³;
2. the granting and negotiation of credits as well as the management of credits by the creditor¹²⁴;
3. the negotiation of and the entry into any dealings in credit guarantees or any other security for money as well as the management of such guarantees by the creditor.¹²⁵
4. operations, including negotiation, concerning deposits, current account transactions, debt-claims, cheques and other negotiable instruments, with the exception (enforced) collection of debt-claims. This provision includes certain factoring services; the compensation for the opening and administrative management of a bank account, the calculation of interest paid and simple collection transactions (without enforcement).¹²⁶;
5. operations, including negotiation, concerning payment and receivables, except for the (enforced) collection of debt-claims; however, if certain conditions are met the supplier of such services may opt for taxation¹²⁷;
6. transactions, including negotiations concerning currency, banknotes and coins used as legal tender, except for coins and banknotes which are regarded as collectors' items; i.e. gold, silver or other metal coins or banknotes, which are not normally used as legal tender or which are of numismatic interest¹²⁸;
7. transactions, including negotiation but not management or safekeeping, concerning shares, participations in companies or associations, debentures and other securities, but excluding documents representing goods.¹²⁹ This exemption includes bond-lending and stock-lending;
8. operations performed by the collective investment institutions referred to in the law of 4 December 1990 on financial transactions and financial markets, including the management of these institutions and their assets. This exemption applies to Belgian collective investment institutions and foreign collective investment institutions, whose participations are traded in Belgium¹³⁰;
9. the supply, at face value, of postage stamps to be used in Belgium, fiscal stamps and other similar stamps¹³¹; and
10. transactions in investment gold¹³².

The listed exemptions are in accordance with Article 13B of the Sixth Directive.

¹²³ Art. 44(3)(4) VATC,

¹²⁴ Art. 44(3)(5) VATC.

¹²⁵ Art. 44(3)(6) VATC.

¹²⁶ Art. 44(3)(7) VATC.

¹²⁷ Art. 44(3)(8) VATC and Circular of 26 October 1979, published in the BTW-Revue, no. 43, p. 23.

¹²⁸ Art. 44(3)(9) VATC.

¹²⁹ Art. 44(3)(10) VATC.

¹³⁰ Art. 44(3)(11) VATC.

¹³¹ Art. 44(3)(12) VATC.

¹³² Art. 44bisVATC. and Circular 3/2000, BTW-Revue 148/79, as modified by Circulars 6/2002 of 12 March 2002 and 16/2002 of 5 August 2002.

BULGARIA

Pursuant to article 46 of the Bulgarian VAT Act the following financial services are exempt:

1. the negotiation, the granting and the management of credit for a consideration (interest) by the person granting it, including the granting, negotiation and management of credit upon supply of goods pursuant to a lease contract;
 2. the negotiation of guarantees and transactions in guarantees or securities establishing title to money receivables, as well as management of guarantees by the creditor;
 3. the transactions, including negotiation, concerning bank accounts, transfers, payments, debts, receivables, cheques and other such negotiable instruments, excluding transactions concerning debt collection and factoring and the hire of safes;
 4. the transactions, including negotiation, concerning currency, banknotes and coins used as legal tender, with the exception of banknotes and coins which are not normally used as legal tender or are of numismatic interest;
 5. the transactions, including negotiation, concerning corporate interests, shares or other securities and derivatives thereof, with the exception of management and safekeeping; this shall not apply to any securities establishing titles to goods or services other than such specified in this Article;
 6. management of the activity of collective investment schemes, investment companies of the closed-end type, and the provision of investment advice according to the procedure established by the Public Offering of Securities Act;
 7. financial-futures contracts and options.
2. In the cases of supplies pursuant to a lease contract under Paragraph 1(1), the supplier shall be allowed a right of option for taxation of the granting of the credit.
 3. In respect of the supplier of financial services under Paragraph 1(1), credit for input tax shall become fully deductible in compliance of the requirements of Article 71 herein for the goods subject to the lease contract under Paragraph 1(1).

Pursuant to article 47 the following Insurance Services are VAT exempt:

The performance of services under the terms and according to the procedure established by the Insurance Code shall be exempt supplies where performed by:

1. insurers;
2. insurance brokers and insurance assistants (agents).

CYPRUS

Schedule Seventh, Table B, paragraphs 1 and 3(a)-(e) of the Cyprus VAT Law provides the following exemptions:

1. Insurance and reinsurance transactions, including related services, performed by insurance agents, brokers and brokers' agents.
2. (*omissis*)
3. The following financial transactions:
 - (a) the granting and the negotiation of the following credit facilities and their management by the person granting them:
 - (i) granting of any loan;
 - (ii) advance for a bill of lading;
 - (iii) discounting on any promissory note or on any bill of exchange;
 - (iv) the granting of any credit, including the supply of credit by a person, in connection with a supply of goods or services by him, for which a separate charge is made and disclosed to the recipient of the supply of goods or services;
 - (v) the provision of the facility of instalment credit finance in a hire-purchase, conditional sale or credit sale agreement for which facility a separate charge is made and disclosed to the recipient of the supply of goods;
 - (b) the granting of any financial guarantee or the undertaking of any other financial responsibility or obligation and the negotiation of the undertaking of these transactions, as well as the management of any credit by the person who grants them;
 - (c) transactions, including negotiation, concerning deposit, current accounts, transfer of money, issue and management of methods of payment (including credit cards, travellers' cheques and bankers' drafts) and other negotiable instruments, but excluding:
 - (i) debt collection, and
 - (ii) factoring;
 - (c) transactions, including negotiation, concerning currency, bank, notes and coins used as legal tender, with the exception of collector's items; "collector's items" shall be taken to mean gold, silver or other metal coins or bank notes which are not normally used as legal tender, or coins of numismatic interest;
 - (d) transactions, including negotiation, excluding management and safekeeping, in shares, securities, bonds, founders' and other shares in companies and rights over them, public securities, interests and other securities excluding:
 - (i) documents establishing title to goods, and
 - (ii) titles of registration of immovable property.
 - (e) the management of mutual funds.

CZECH REPUBLIC

The term, financial services, is defined in section 54 of the Czech VAT Law and includes the following activities:

- transfer of securities
- receipt of deposit from the public
- provision of credits and monetary loans
- payment and clearing arrangements
- issue of payment instruments, such as payment cards or traveller's cheques
- provision of bank guarantees
- opening and advice on opening a letter of credit and its confirmation
- arrangements for money collection
- foreign currency exchange operations
- money operations
- supplying gold to the Czech National Bank and receipt of deposits by the Czech National Bank from banks and the State
- the organizing of a regulated market in investment instruments
- receipt and transfer of orders (instructions) concerning investment instruments when trading on a customer's account
- implementation of orders (instructions) concerning investment instruments on someone else's account
- trading in investment instruments on own account for someone else
- management of client's assets on the basis of a contract with the client provided that the assets include an investment instrument, but excluding the administration or custody of investment instruments
- underwriting or placement of issues of investment instruments
- keeping records of investment instruments
- settlement of transactions in investment instruments
- trading in foreign exchange values on own account or on client's account
- assignment of a receivable (having already been assigned by someone else) for consideration
- management of investment funds or unit trusts
- collection of radio and television charges
- payment of social security benefits or collection of recurrent payments from citizens
- negotiating or intermediary activities related to the operations above

DENMARK

The following supplies of goods and services are exempt according to Sec. 13(1) in the Danish VAT Act:

1. Insurance and reinsurance activities, including services in connection therewith, which are supplied by insurance brokers and insurance intermediaries.
2. The following financial activities:
 - (a) the granting and the negotiation of credit and the management of credit by the person granting it;
 - (b) the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;
 - (c) transactions, including negotiations, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt-collection;
 - (d) transactions, including negotiations, concerning currency, bank notes and coins used as legal tender with the exception of collectors' items;
 - (e) transactions, including negotiations, but excluding safe-keeping and management, in securities, apart from documents establishing title to goods and documents which grant specific rights, including rights of use, to immovable property, and also parts and shares if the possession thereof legally or in fact secures rights as an owner or user to an immovable property or a part of an immovable property;
 - (f) management of investment fund organizations.

Section 13(2)

Supplies of goods exclusively applied in connection with activities exempted from VAT according to Sec. 13(1)(1-22) of the VAT Act are also exempted from VAT. Supplies of goods are also exempted from VAT where the VAT on the acquisition or application of the goods in question was not deductible.

ESTONIA

The supplies of the following insurance and financial services are exempt from VAT under Article 16(2) 1), 5) and 6) of the VAT Act:

- insurance services, including reinsurance and insurance mediation;
- the following financial transactions and negotiation services related thereto:
 - 1) deposit transactions for the receipt of deposits and other repayable funds from the public;
 - 2) borrowing and lending operations, including consumer credit, mortgage credit, transactions for financing business transactions;
 - 3) leasing transactions;
 - 4) settlement, cash transfer and other money transmission transactions;
 - 5) issue and administration of non-cash means of payment (e-g. electronic payment instruments, traveler's cheques, bills of exchange);
 - 6) guarantees and commitments and other transactions creating binding obligations to persons;
 - 7) transactions in traded securities and in foreign currency and other money market instruments, including transactions in cheques, exchange instruments, certificates of deposit and other such instruments;
 - 8) transactions and acts related to the issue and sale of securities;
 - 9) money broking;
- management of public funds, including pension funds.

FRANCE

Article 261 C (1) and (2) CGI provides for a list of exempt banking and financial transactions. This list closely follows the one set out in Article 13 B (a) and (d) of the 6th Directive. This list includes, amongst others:

- credit operations, such as the granting and negotiation of credit¹³³;
- the negotiation or any dealings in credit guarantees or any other securities, as well as the management of credit guarantees by the person who is granting the credit¹³⁴;
- transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, checks and other negotiable instruments, but excluding debt collection¹³⁵;
- transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collector's notes and collector's bank notes¹³⁶;
- transactions, excluding management and safe-keeping, in shares, interests in companies or associations, debentures and other securities excluding representative interests in goods and rights in rem giving the holder thereof a right of user over immovable property¹³⁷;
- the management of OPCVMs (French UCITS) and FCC (*Fonds commun de créance*)¹³⁸; and
- transactions in respect of gold other than for industrial usage when they are made by certain suppliers, including credit establishments or suppliers of investment services¹³⁹; and
- operations of insurance and reinsurance as well as supplies of services pertaining to these operations, carried out by agents and insurance intermediaries¹⁴⁰.

¹³³ Art. 261 C (1) (a) CGI

¹³⁴ Art. 261 C (1) (b) CGI

¹³⁵ Art. 261 C (1) (c) CGI

¹³⁶ Art. 261 C (1) (d) CGI

¹³⁷ Art. 261 C (1) (e) CGI

¹³⁸ Art. 261 C (1) (f) CGI

¹³⁹ Art. 261 C (1) (g) CGI

¹⁴⁰ Art. 261 C (2) CGI

GERMANY

Financial services, which are exempt under Article 4 number 8(a)-(h) VAT Act:

- a. the granting and negotiation of credits;
- b. turnover derived from transactions (including negotiation) concerning currency used as legal tender, with the exception of collector's items;
- c. turnover derived from transactions (including negotiation) concerning debts, cheques and other negotiable instruments, but excluding debt collection;
- d. turnover derived from transactions, including negotiation concerning deposit and current accounts, payments, transfers and the collection of commercial papers;
- e. turnover derived from transactions, including negotiation concerning shares, excluding management and safekeeping;
- f. turnover derived from transactions, including negotiation concerning interests in companies and other associations;
- g. the assumption of debts, of guarantees and other securities and the negotiation of turnovers derived from these transactions; and
- h. the administration of special investment funds pursuant to the German Investment Act and the administration of pension facilities pursuant to the German Insurance Supervision Act.

GREECE

Exemptions (Article 22 VAT Law)

Inter alia, the following financial services shall be exempt from tax:

- a. (...);
- b. the following deliveries and services:
 - (i) activities, including intermediary activities, concerning foreign currency, bank notes and coins which serve as legal tender in any country, with the exception of bank notes and coins which are not generally used as legal tender or which are collector's items;
 - (ii) activities, including intermediary activities but not including safekeeping and administration, with respect to securities other than those securities which represent goods; and
 - (iii) management of collective investment funds;
- c. the following services:
 - (i) the rendering of credit and intermediary activities with respect to credit;
 - (ii) activities, including intermediary activities, with respect to the operation of current accounts, deposits, payments, transfers, debt claims, and cheques and other such trade documents, with the exception of the collection of debt claims; and
 - (iii) the entering into, and intermediary activities with respect to, all guarantee contracts;
- d. insurance and the services rendered by insurance agents.

HUNGARY

This is the list of exempt financial services (it is not included in the Annex to the VAT Act like this. There are only numbers in the Annex referring to the statistical numbers of the Official List of Services. So I copy below the relevant part of that Official List):

65.11 Central banking

This class includes:

- account management for credit institutions for clearing transactions, provision of banking services to the state, obtaining and redistributing funds with respect to the entities specified in the legislation governing the operations of the central bank (single treasury account, other designated government accounts and the operating accounts of specific financial institutions), account management and lending activities with respect to the same entities, supervision of banking operations, management of currency reserves, issue of bank notes and control of the quantity of currency in circulation.

65.12 Other monetary intermediation

This class includes:

- monetary intermediation of monetary credit institutions other than the central banks:
- account management and lending activities,
- payment transaction services,
- credit card activities.
- postal giro and postal savings activities and other financial activities.

65.21 Financial leasing

65.22 Other credit granting

This class includes:

- lending operations by institutions not engaged in financial intermediation:
- granting consumer credit granting loans,
- long- term financing of production,
- loan activities credit granting other than by banks,
- loans provided credit granting by non-deposit taking mortgage institutions not engaged in the collection of deposits,
- factoring,
- activities of mortgage brokers finance companies (brokers).

65.23 Other financial intermediation n.e.c.

This class includes:

- other financial intermediation primarily concerned with distributing funds other than by making loans,
- investment in securities (e.g.e.g., shares, bonds, bills, unit trust units, etc.),
- dealing for own account by securities dealers,
- investment in property where this is carried out primarily for other financial intermediaries (e.g.e.g., property unit trusts),
- writing of swaps, options and other hedging arrangements.

This class excludes:

- financial leasing cf. 65.21,
- security dealing on behalf of others cf. 67.12,
- trade, leasing and renting of property cf. 70,
- operational leasing cf. 71.

66.01 Life insurance

This class includes:

- life insurance and life reinsurance, with or without a savings element (individual retirement and annuity plans).

66.02 Pension funding

This class includes:

- the provision of retirement incomes on the basis of funding, pension fund management.

This class excludes:

- non-contributory schemes where the funding is largely derived from public sources cf. 75.12,
- compulsory social security schemes cf. 75.30,

66.03 Non-life insurance

This class includes:

- insurance and reinsurance of non-life business:
- accident, fire,
- health,
- property,
- motorcycle, motor vehicle, aviation, other means of transport, consignments,
- pecuniary loss and liability insurance,
- credit insurance and surety,
- reinsurance in connection with pension funding and non-life insurance etc.

67.1 Activities auxiliary to financial intermediation

67.11 Administration of financial markets

This class includes:

- operation and supervision of financial markets other than by public authorities,
- supervision and control (non-regulatory) of stock exchanges, commodity exchanges etc.

67.12 Security broking and fund management

This class includes:

- dealing in financial markets on behalf of others, security dealing (e.g.e.g., stock broking and related activities),
- fund management.

This class excludes:

- activities of stock brokers dealing in markets on own account, cf. 65.23

67.13 Activities auxiliary to financial intermediation n.e.c.

This class includes:

- activities auxiliary to financial intermediation not elsewhere classified, e.g.:
- mortgage brokers,
- bureaux de change etc.

67.2 Activities auxiliary to insurance and pension funding

67.20 Activities auxiliary to insurance and pension funding

This class includes:

- activities involved in or closely related to insurance and pension funding other than financial intermediation:
- activities of insurance agents,
- activities of insurance risk and damage evaluators,
- investigation in connection with insurance, cf.

IRELAND

- i) Financial exempt services consisting of:
- (a) the issue, transfer or receipt of, or any dealing in, stocks, shares, debentures and other securities, other than documents establishing title to goods,
 - (b) the arranging for, or the underwriting of, an issue specified in (a),
 - (c) the operation of any current, deposit or savings account and the negotiation of, or any dealings in, payments, transfers, debts, cheques and other negotiable instruments excluding debt collection and factoring,
 - (d) the issue, transfer or receipt of, or any dealing in, currency, bank notes and metal coins, in use as legal tender in any country, excluding such bank notes and coins when supplied as investment goods or as collectors' pieces,
 - (e) the granting of and the negotiation of credit and the management of credit by the person granting it,
 - (f) the granting of, or any dealing in, credit guarantees or any other security for money and the management of credit guarantees by the person who granted the credit,
 - (g) the management of an undertaking specified in one of the following clauses, and such management may comprise any of the three functions listed in Annex II to Directive 2001/107/EC of the European Parliament and Council (being the functions included in the activity of collective portfolio management) where those functions are supplied by the person with responsibility for the provision of the functions concerned in respect of the undertaking, and which is:
 - (I) a collective investment undertaking as defined in Sec. 172A of the Taxes Consolidation Act 1997 (as amended by Sec. 59 of the Finance Act 2000), or
 - (Ia) a special investment scheme within the meaning of Sec. 737 of the Taxes Consolidation Act 1997, or
 - (II) administered by the holder of an authorization granted pursuant to the European Communities (Life Assurance) Regulations, 1984 (S.I. 57 of 1984), or by a person who is deemed, pursuant to Article 6 of those Regulations, to be such a holder, the criteria in relation to which are the criteria specified in relation to an arrangement administered by the holder of a licence under the Insurance Act, 1936 in Sec. 9(2) of the Unit Trusts Act 1990, or
 - (III) a unit trust scheme established solely for the purpose of superannuation fund schemes or charities, or
 - (IV) determined by the Minister for Finance to be a collective investment undertaking to which the provisions of this subparagraph apply, or
 - (V) an undertaking which is a qualifying company for the purposes of Sec. 110 of the Taxes Consolidation Act 1997;
 - (gg) [deleted by Sec. 85 of the Finance Act 1991, with effect from 29 May 1991],
 - (h) services supplied to a person under arrangements which provide for the reimbursement of the person in respect of the supply by him of goods or services in accordance with a credit card, charge card or similar card scheme;

ITALY

Exempt financial services provided for by Article 10 of Italian VAT Code exempts:

1. The supply of services relating to the granting and negotiating of credit operations and the management of same by grantors as well as financing transactions^{141 142 143}, the assumption of financial obligations, sureties and other guarantees and the management of credit guarantees by grantors; payment extensions, transactions, including those transactions relating to deposit of funds, current accounts, payments, contra accounts, receivable, checks or negotiable bills with the exception of credit collection¹⁴⁴; management of mutual funds and pension funds ex Leg. Dec. 124 of April 21 1993, payment extensions and the management of similar transactions and the service of the post bank;
2. insurance and reinsurance as well as life annuities operations¹⁴⁵;
3. operations relating to foreign currency with an official exchange rate and credits in foreign currency, with the exception of coins and bills for collection including hedging operations against risks of exchange rates fluctuations;
4. activities relating to shares, bonds and other instruments not representing merchandise, and to participations, other than shares, in companies, excluding the safe custody and administration of shares or other securities, etc.; operations including negotiations and options, with the exception of the safe custody and administration relating to securities and financial instruments other than credit instruments. Operations relating to securities and financial instruments, fixed-term futures and other financial instruments as well as other options pertaining thereto which are, in any event, regulated; futures on interest rates and possible options; exchange contracts for sums of money or currency determined on the basis of interest rates, exchange rates or financial ratios and possible options; options on currencies, on interest rates or financial ratios which are, in any event, regulated;
9. mandates, mediation and intermediation services relating to the transactions mentioned under 1. through 7., as well as those relating to transactions in gold and foreign currency, including deposits, even in current accounts, effected in connection with transactions carried out by the Italian Central Bank and the Italian Exchange Office, in accordance with Art. 4, Para. 5 of this Decree;

(...)

27-*quinquies*. transfer of goods purchased or imported without any right to claim total deductibility of the related tax as under Arts. Nos. 19, 19-bis1 and 19-bis2;

¹⁴¹ It has been amended by article 4 of Law 18 February 1997, No. 28 according to article 13B d) of the Sixth Directive.

¹⁴² In line with ECJ judgment of 5 June 1997 No. C-2/95, the Italian administration in its Resolution No. 205 of 10 December 2001 clarified that are VAT exempt also a number of services carried out by companies, other than banks, rendered to a financial institution.

¹⁴³ Article 4 of the Law 13 May 1999, No. 133 expressly provides that the "*pronti contro termine* transaction" fall within the scope of article 10 of Italian VAT Code and are, therefore, exempt.

¹⁴⁴ Please note in a decision dated 26 June, 2003 (case C-305/01 / MKG-GmbH; V-N 2003/34.13), the ECJ held that assignments of receivables to a factoring company are to be treated as a recovery of claims and, therefore, the fees paid to the factoring companies are to be subject to the standard VAT tax rate. However, Italian tax authorities with the ministerial resolution No. 139/E of 17 November 2004 confirmed the interpretation of the Italian VAT Code, stating that the assignment of claims to a financial institution for financing purposes is a VAT exempt transaction.

¹⁴⁵ Please note that, to some extent, the interpretation given by the Italian tax authority is in line with the ECJ decision dated 25 February 1995 No. C-349/96 and 20 November 2003 No. C-8/01.

LATVIA

The following financial and insurance services are exempt from VAT under Article 6(1)13) and 17) of the VAT Act:

- insurance and re-insurance services provided by insurers and insurance agents;
- the following financial transactions:
 - (a) granting and control of credits and monetary loans, as well as services related to sureties and guarantees and their supervision which is performed by the lender;
 - (b) services, which are related to the attraction of deposits and other refundable funds, the execution of payments in cash and other than cash payments, and fiduciary (trust) operations;
 - (c) services related to the issuing and servicing of instruments of payment, as well as trading in instruments of payment and other money market instruments, except instruments of payment supplied for collections or containing precious metals; and
 - (d) services (including intermediary), which are associated with investments in capital and with the holding, disposal and administration of securities, as well as the issuing of securities.

LITHUANIA

VAT non-taxable financial services include the following (Article 28 of the VAT Act):

- (i) provision of loans as well as servicing of provided loans, if such is performed by the same person who provided the loans;
- (ii) provision of financial guaranties or sureties as well as their servicing, if such is performed by the same person who provided the financial guaranties or sureties¹⁴⁶;
- (iii) acceptance and management of deposits and other repayable funds, clearing of inter-bank payment, other services related to organization of payment, transfer of money, organization of non-cash payments (including issuance of bank cards and other means of payment, servicing of bank card holders, performance of related operations), issuance of letters of credit and related operations, as well as transactions under promissory notes¹⁴⁷;
- (iv) currency transactions (including currency exchange), as well as acceptance and disbursement of cash, money management and other services directly related to banknotes and coins of any currency¹⁴⁸;
- (v) transactions regarding securities, derivative financial instruments, as well as intermediation in the mentioned transactions and other services directly related to the mentioned transactions (organization, execution, registration, etc. of securities issue), except for:
 - a) transactions regarding securities confirming the rights to immovable property;
 - b) transactions regarding securities¹⁴⁹ confirming the rights to goods (not covered in sub-item a) above);
 - c) transactions regarding securities confirming the right or obligation to acquire or transfer securities covered in sub-item b) above;
 - d) custody services in respect of securities and/or derivative financial instruments;
 - e) portfolio management services in respect of securities and/or derivative financial instruments, consulting on investment into securities and/or derivative financial instruments, market research services in respect of securities and/or derivative financial instruments.
- (vi) management services of variable-capital investment companies, investment funds and pension fund assets.

¹⁴⁶ Except for financial services directly linked to the export of goods (not covered by intra-Community non-taxable supplies) from the Community which are zero-rated (Art 46 of the VAT Act).

¹⁴⁷ However, debt recovery services and services rendered under the factoring agreements do not fall under the VAT non-taxable services.

¹⁴⁸ The detailed list of VAT non-taxable financial services mentioned in Items (i)-(iv) is set by Order No. 157 of the Minister of Finance of 6 June 2002.

¹⁴⁹ Except for securities confirming the rights to investment gold (Art 111 of the VAT Act).

LUXEMBOURG

The Luxembourg VAT Code contains the following exempt financial services, which cover typical banking activities:

- 1) The granting, negotiation of a credit by the creditor and rediscount transactions.¹⁵⁰
- 2) The entry into and the negotiation of credit guarantees or any other security for credit, the negotiation of such operations, as well as the administration of such guarantees by the creditor.¹⁵¹
- 3) Operations in respect of receivables, except debt collection, and the negotiation of such operations.¹⁵²
- 4) Operations in respect of cheques and other commercial paper, as well as the negotiation of such operations.
- 5) Operations in respect of deposits and current accounts, as well as the negotiation of such operations.
- 6) Payments and bank transfers, as well as the negotiation of such operations.
This exemption covers credit card services, but not debt collection services, which are subject to VAT.
- 7) Operations, including negotiation, in respect of currencies, banknotes and coins which are considered legal means of payment, except coins and banknotes which are collector's items. Gold and silver coins, coins in other metals and bank notes that are not usually used as legal means of payment or which present a numismatic interest are considered to be collectors' items.
- 8) The operations, other than custody and administration services which are taxed at the reduced rate of 12%, on securities and shares, units and company bonds and similar documents except those establishing title to goods, as well as the negotiation of such operations.

The following transactions are, however, exempt from VAT:

- a) the payment of interest coupons and the redemption and collection of redeemable securities;
 - b) share exchanges;
 - c) share splits;
 - d) exercise or waiver of pre-emption and other rights attaching to securities;
 - e) periodic statements/valuations at the client's request; and
 - f) delivery and transfer of securities.
- 9) Certain services in relation to the issuance of securities are exempt.
- 10) Management of undertakings for collective investment and pension funds subject to the supervision of the "CSSF" (public body in charge of the supervision of the financial sector) and the "Commissariat aux Assurances" (public body in charge of the supervision of the insurance sector) as well as of securitization bodies and of "SICAR" (investment companies in venture capital) situated in Luxembourg.

Management services which are not part of the core financial services of a bank are taxable, except for the management of investment funds¹⁵³.

¹⁵⁰ Art. 44(1)(c) VAT Code.

¹⁵¹ Art. 44(1)(c) VAT Code contains an overview of exemption for financial services.

¹⁵² Art. 44(1)(e) VAT Code.

¹⁵³ Art. 44(1)(d) VAT Code.

Survey on the recovery of input VAT in the financial sector
December 2006

- 13) Insurance and re-insurance transactions, including related services performed by insurance brokers and insurance agents. This exemption does not apply to supplies of loss adjusters.

MALTA

Exempt insurance and financial services in terms of Part 2 of the Fifth Schedule to the Malta VAT Act

Insurance services

The supply by persons licensed under the Insurance Business Act or the Insurance Brokers and Other Intermediaries Act*, of insurance and reinsurance services, including related transactions, in respect of which they are so licensed.

Credit, banking and other services

- (1) The granting and the negotiation of credit and the management of credit by the person granting it.
- (2) The negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit.
- (3) Transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection and factoring.
- (4) Transactions, including negotiation, concerning currency, bank notes and coins normally used as legal tender.
- (5) Transactions, including negotiation, excluding management and safekeeping, in shares, interest in companies or associations, debentures and other securities, excluding:
 - a. documents establishing title to goods;
 - b. certain interest in immovable property;
 - c. rights *in rem* giving the holder thereof a right of user over immovable property;
 - d. shares or interests equivalent to shares giving the holder thereof de jure or de facto rights of ownership or possession over immovable property or part thereof.
- (6) The supply of services consisting of the management or arrangement of any scheme as specified in the First Schedule to the Investment Services Act, by a person duly authorized by a licence issued under that Act.

* recently repealed and replaced by the Insurance Intermediaries Act (the VAT Act has not been amended to reflect the change).

NETHERLANDS

Under Article 11(1) of the VAT Act, an exemption applies to, inter alia, financial services as referred to in subparagraphs (i) and (j), and insurance transactions as referred to in subparagraph (k), as follows:

- i. the following supplies of goods and services:
 - transactions, including brokerage, concerning foreign currency, bank notes and coins, which are legal tender in any country, with the exception of bank notes and coins that are normally not used as legal tender or that have collectors' value;
 - 1. transactions, including brokerage, but with the exception of custodial activities and management, concerning stocks and shares and other securities, with the exception of documents representing goods;
 - 2. management of capital brought together for collective investment by investment funds and investment companies;
- j. the following services:
 - the provision and brokerage of credit;
 - 1. transactions, including brokerage, concerning giro and current account transactions, deposits, payments, transfers, debt claims, cheques and other commercial documents, with the exception of debt collection;
 - 2. entering into and brokering contracts of security and other insurance and guarantee agreements;
- k. insurances and services supplied by insurance intermediaries;

POLAND

The following services are, *inter alia*, exempt from VAT:

1. Insurance advisory and valuation services for insurance companies, except for services performed by insurance company themselves;
2. Services related to mandatory social insurances.

As regards financial transactions exempt from VAT provided by the Article 13.B, point (d) of the Sixth Directive, the following financial transactions are exempt from VAT under the Polish VAT law:

1. Supply, also via brokerage, of foreign currencies, banknotes and coins used as legal tender, except for collectors' items (*Article 43.1.7 of the Polish VAT Law*);
2. Services of managing investment funds and collective investment portfolios (*Article 43.1.12 of the Polish VAT Law*);
3. Financial brokerage (*the Attachment nr 14 to the Polish VAT Law*), excluding the services of:
 - Pawnbrokers, with exemption for banks;
 - Leasing;
 - Financial advisory;
 - Factoring and collecting debts;
 - Management of shares, interests in companies or associations, debentures and other securities;
 - Safekeeping of shares, interests in companies or associations, debentures and other securities.

PORTUGAL

The corresponding parts of Article 9 of the Portuguese VAT Code dealing with financial services read as follows:

(...)

28. The following operations are exempt from VAT:

- a) Granting and the negotiation of credit, under any form, including discount and rediscount transactions, and the management of credit by the person granting it;
- b) Negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;
- c) Transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding operations of simple debt collection;
- d) Transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of metal coins or bank notes which are not normally used as such or that have a numismatic interest;

e) Deleted

- f) Transactions and services, including negotiation, but excluding management and safekeeping, related to shares, interests in companies or associations, debentures and other securities, excluding documents establishing title to goods and securities representative of operations over immovable property when undertaken for a period of less than 20 years;
- g) Services and operations related to the issuance, taking and purchase of public and private security offerings;
- h) Administration and management of investment funds.

29. Insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents are exempt from VAT.

(...)

ROMANIA

Financial services

VAT non-taxable financial services include the following (point 2, letter a 1 to 6 of Art 141 of the Tax Code):

- (i) Provision and negotiation of loans as well as servicing of provided loans, if such is performed by the same person who provided the loans;
- (ii) Provision, negotiation and overtake of financial guaranties or sureties as well as their servicing, if such is performed by the same person who provided the financial guaranties or sureties;
- (iii) Any operation, including negotiation, carried on in connection with deposits, current accounts, payments, transfer of money, debits, cheques and other commercial receivables, except for debt recovery services and factoring services;
- (iv) currency transactions, including currency exchange, as well as acceptance and disbursement of cash, and other services directly related to banknotes and coins of any currency, except for pieces of collection;
- (v) transactions regarding securities, derivative financial instruments, as well as intermediation in the mentioned transactions and other services directly related to the mentioned transactions, except for portfolio management and custody services. Transactions with securities confirming ownership of goods do not qualify;
- (vi) management services of variable-capital investment companies, investment funds and mutual debt assurance funds.

Insurance services

According to point 2, letter b of Art 141 of the Tax Code, VAT non-taxable services include insurance and re-insurance of all types, as well as related services rendered by insurance brokers and agents.

SLOVAK REPUBLIC

According to Article 39(1) of the VAT Act the following financial services are exempt from VAT:

- the granting and the negotiation of credit, the granting and the negotiation of loan, the management of credit and loan by the person granting it, and negotiation of savings;
- the granting and the negotiation of credit guarantee and any other security for money, as well as the management of credit guarantee by the person granting the credit;
- transactions concerning deposit and current accounts, including their negotiation;
- transactions concerning payments, transfers, cheques, negotiable instruments, debts, but excluding debt collection;
- the issuance and management of electronic payment instruments and traveler's cheques;
- transactions concerning securities and participating interests, including their negotiation; whilst excluding management and safekeeping of securities;
- opening of letters of credit;
- procurement of collection;
- transactions concerning currency used as legal tender, including their negotiation;
- exchange transactions;
- the management of share funds by an asset management company in accordance with the special provision*;
- the management of pension funds by a pension asset management company in accordance with the special provision**;
- the management of supplementary pension funds by a supplementary pension company in accordance with the special provision***;
- trading for one's own account or for the customer's account in forwards, futures contracts and options, including the exchange rate and interest rate transactions.

* Act No 594/2003 Coll. on Collective Investment as amended

** Act No 43/2004 Coll. on Old-age Pension Savings as amended

*** Act No 650/2004 Coll. on Supplementary Pension Savings as amended

SLOVENIA

According to Article 44 (1) and (4) of the VAT Act insurance and reinsurance transactions, including related services performed by insurance brokers and agents and some financial services are exempt from VAT.

Insurance and reinsurance business mentioned in Article 44 (1) of the VAT Act comprises the conclusion and performance of contracts on property and life insurance, reinsurance and co-insurance.

The following financial services are exempt:

- (a) the granting and the negotiation of credit or loans in monetary form and the management of credit or loans in monetary form by the person who is granting the credit or the person who is granting the loan,
- (b) the issuing of credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit,
- (c) transactions, including negotiation, concerning deposit and current or transaction accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection and factoring,
- (d) transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of bank notes and coins whose salable value is determined on the basis of their value as collectors' items or on the basis of the value of the metal from which they are made,
- (e) transactions (excluding management, safekeeping, investment advice and services in connection with takeovers), including negotiation, in shares, interests in companies or associations, debentures and other securities, excluding documents establishing title to goods and the rights and interests referred to in point 4 of the second paragraph of Article 4 of this Act,
- (f) the management of investment funds.

SPAIN

Pursuant to article 20 of the Spanish law the following financial transactions are exempt:

(16) Insurance and reinsurance transactions and transactions providing for retirement benefits even by way of a lump sum, including related services performed by insurance and reinsurance brokers and agents.

(17) *omissis*

(18) Financial transactions in respect of:

- (a) any kind of deposit in cash, savings and current accounts, transactions of payment into account of cheques or counterfoils, and transactions related thereto, including the payment and collection services rendered by the depositary to the depositor, and excluding the services related to the management collection of loans, bills of exchange, receipts and other similar documents;
- (b) the transfer of deposits in cash including by the use of deposit certificates or similar instruments;
- (c) the granting of credits and loans in cash by any type of financial title or instrument;
- (d) any other transactions relating to loans, credits, including management of credits, and financial swaps, made by those parties who fully or partially grant them; except for the services performed to other lenders in syndicated loans;
- (e) the transfer of loans and credits;
- (f) the granting of, or any dealings in, credit pledges, cautions and personal or *in rem* guarantees, by the lenders of the credits or loans secured or by the guarantors;
- (g) the transfer of guarantees;
- (h) transactions concerning transfers, money orders, cheques, drafts, promissory notes, bills of exchange, credit and debit cards and other types of payment orders, including the interbanking clearing of cheques and counterfoils, the acceptance and management of the acceptance and the noting of bills of exchange and management thereof, excluding the collection service of bills of exchange or other documents that were received during this service;
- (i) the transfer of drafts and payment orders as referred to in letter (h) above, including the transfer of discounted drafts and excluding the assignment of drafts in collecting commission;
- (j) transactions, including the sale, purchase and exchange concerning foreign currency, bank notes and coins used as legal tender, excluding:
 - collectors' items (i.e. gold, silver and other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest);
- (k) transactions, concerning any shares, stocks and interests in companies, debentures and other securities not referred to under (18), including their transfer, and excluding:
 - (a) the management and safekeeping of securities;
 - (b) documents establishing title to goods (such as warrants);
 - (c) securities giving the holder thereof "de jure" or "de facto" rights of ownership, possession or exclusive use of immovable property (or part thereof); company shares or participations are not included;
- (l) the transfer of securities as referred to in point (k) above and any related services including their issue and amortization and with the same exceptions;
- (m) negotiation and agency services concerning any of the exempt financial transactions referred to in (18)(a) through (l) above and any similar transactions that are not

carried out during the normal course of business or professional activities; the exemption also covers agency services for the transfer or placing in the market of deposits, loans in cash or in securities made on account of their issuing entities, of the holder or other agencies, including those cases which underwrite these transactions;

- (n) the management and deposit of group investment institutions of venture capital, entities managed by authorized management companies duly registered in the appropriate administrative registries, pension funds, regulation of the mortgage market funds, mortgage backed securities and group retirement funds established according to their special legislation;
- (o) execution services, concerning financial transactions as referred to in (18)(a) to (j) performed by stockbrokers, registered trade brokers, public notaries and registrars of public deeds and similar transactions that are not carried out during the normal course of business or professional activities, including services regarding the classification, registration and other services related to the constitution, modification and redemption of the guarantees as referred to in the letter (f) above.

UK

Exempt financial transactions (Group 5, Schedule 9, VATA):

Item No.

1. The issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money.
2. The making of any advance or the granting of any credit.
3. The provision of the facility of installment credit finance in a hire purchase, conditional sale or credit sale agreement for which facility a separate charge is made and disclosed to the recipient of the supply of goods.
4. The provision of administrative arrangements and documentation and the transfer of title to the goods in connection with the supply described in item 3 if the total consideration therefore is specified in the agreement and does not exceed £ 10.
5. The making of arrangements for any transaction comprised in item 1, 2, 3 or 4 or the underwriting of an issue within item 1.
- 5A. The underwriting of an issue within item 1 or any transaction within item 6.
6. The issue, transfer or receipt of, or any dealing with, any security or secondary security being:
 - (a) shares, stocks, bonds, notes (other than promissory notes), debentures, debenture stock or shares in an oil royalty; or
 - (b) any document relating to money, in any currency, which has been deposited with the issuer or some other person, being a document which recognizes an obligation to pay a stated amount to bearer or to order, with or without interest, and being a document by the delivery of which, with or without endorsement, the right to receive that stated amount, with or without interest, is transferable; or
 - (c) any bill, note or other obligation of the Treasury or of a government in any part of the world, being a document by the delivery of which, with or without endorsement, title is transferable, and not being an obligation which is or has been legal tender in any part of the world; or
 - (d) any letter of allotment or rights, any warrant conferring an option to acquire a security included in this item, any renounceable or scrip certificates, rights coupons, coupons representing dividends or interest on such a security, bond mandates or other documents conferring or containing evidence of title to or rights in respect of such a security; or
 - (e) units or other documents conferring rights under any trust established for the purpose, or having the effect of providing, for persons having funds available for investment, facilities for the participation by them as beneficiaries under the trust, in any profits or income arising from the acquisition, holding, management or disposal of any property whatsoever.
7. Deleted.
8. The operation of any current, deposit or savings account.
9. The management of an authorized unit trust scheme or of a trust based scheme by the operator of the scheme.
10. The services of the authorized corporate director of an open ended investment company so far as they consist of managing the company's scheme property.