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VAT Exemption for Financial Services in the Banking Sector – The Italian Approach

For more than 20 years, starting with the judgment in *SDC* (Case C-2/95), the Court of Justice of the European Union has provided guidance on the correct interpretation of the EU VAT provisions related to exempt financial (in particular, "related to payments") services supplied to banks and financial institutions. The principles established at the EU level have been adopted by the Italian tax authorities. In this article, the authors first illustrate the historical evolution of the matter, and then seek to suggest a possible application of the consolidated principles in order to extend the exempt treatment to the current economic scenario, which is characterized by increasing fragmentation and complexity of fintech services.

1. Introduction

In the European Union, the VAT treatment of financial services is governed by Council Directive 2006/112/EC (VAT Directive[1]) and the case law of the Court of Justice of the European Union (ECJ). For more than 20 years, the ECJ has provided guidance on the correct interpretation of the VAT Directive, including with respect to the services "related to payments" supplied to banks and financial institutions. Such guidance can be applicable in relation to, but not necessarily limited to, for example, the processing of electronic transactions or card processing. These services typically require the presence of technical providers, whose activities in principle could be subject to VAT (if the strict conditions required by the ECJ for the exemption, which will be illustrated section 2., are not met), so that their clients (banks and other financial institutions) could register an increase of their costs (VAT being a cost for them).

In this article, the authors first illustrate the historical evolution of the matter from an EU and an Italian point of view, and then seek to suggest a possible application of the currently consolidated principles in order to extend the exempt treatment to the current economic scenario, which is characterized by an increasing fragmentation and complexity of fintech services.

2. VAT Rules Governing the Exemption of Financial Services and the Crucial Role of the ECJ

When referring to the VAT exemption of financial services in the European Union, the relevant provision is article 135(1)(d) of the VAT Directive,[2] providing that:

> Member States shall exempt the following transactions:
>
> …
>
> (d) transactions, including negotiation, *concerning* deposit and current accounts, *payments*, *transfers*, debts, cheques and other negotiable instruments, but excluding debt collection. [Emphasis added.]

This provision has been implemented in Italy by article 10(1)(1) (related to "VAT exempt transactions") of Presidential Decree 633/1972 (VAT Decree), providing for the exemption of some financial transactions, among which the ones "related to … payments, transfers …".

The scope of application of the exemption, which in principle is very broad, has been clarified by the ECJ. A "pilot judgement", followed by many others that pointed out the same principles, was the very well-known ECJ judgment in *SDC* (Case C-2/95[3]), in which SDC (an association registered for VAT purposes) supplied services to its customers (banks) by electronic means (through a data-handling centre). SDC had legal obligations with the banks (the latter being SDC's customers from a contractual point of view), while the banks' customers – directly affected by the transfers of funds – did not have legal obligations with SDC but only with the banks. SDC received the remuneration for its supplies of services from the banks and not from the bank's customers. In *SDC*, the ECJ established the following principles, to be taken as the pillars ruling the VAT exemption of these financial services:[4]

(1) the exempt transactions are defined according to the nature of the services provided and not to the person supplying or receiving such services (so the fact that a transaction covered by the exemption provisions is effected by a third party but appears to the end customer to be a service provided by the bank does not imply the exclusion from the exemption); also the

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1. Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, art. 33, OJ L347 (2006), Primary Sources IBFD [hereinafter VAT Directive].
2. Previously, Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, art. 13(B)(d), OJ L145 (1977), Primary Sources IBFD [hereinafter Sixth Directive].
3. DK: ECJ, 5 June 1997, Case C-2/95, *Sparekassernes Datacenter (SDC) v. Skatteministeriet*, Case Law IBFD (accessed 20 Apr. 2021).
4. It is to be noted that in the *SDC* case, as a general principle, the ECJ preliminarily stated that the terms used to describe the exemptions are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person.

manner (electronical, automatic or manual) in which the services are performed is not relevant in order for them to be exempt or not;[5]

(2) in order to be characterized as exempt transactions, it is necessary that the services provided by a data-handling centre (but the same principle applies regardless of the person of the supplier – *see* (1) above), "viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions" of financial services.[6] In particular, for "a transaction concerning transfers", the ECJ has clarified that "the services provided must … have the effect of transferring funds and entail changes in the legal and financial situation" of the service recipient;[7] and

(3) exempt services must be distinguished from mere physical or technical supplies (such as making a data-handling system available to a bank) on the basis of the supplier's responsibility towards the bank. In particular, in order for a service to be exempt, such a responsibility must "extend to the specific and essential aspects of the transactions" (the transfer of funds must be guaranteed) and not be restricted to technical aspects (i.e. the proper working of the data-handling centre).[8]

The relevance of the *SDC* case, specifically, is that it established for the first time that the typically exempt financial services (transfer of funds, related to payments) rendered by a bank to its customers do not lose their exempt nature if they are rendered (in the meaning of executed, technically performed) by a taxable person other than a bank, provided that they maintain their genuine "financial" nature on the basis of the criteria specified by the ECJ. As indicated previously, they must "form a distinct whole having the effect of transferring funds and entail changes in the legal and financial situation" of the recipients, with the mentioned consistent level of responsibility required to the supplier.

It is worth noting that such criteria were used by the same ECJ to exclude the exemption granted, among others, to "transactions, …, concerning … payments, transfers, …" by article 13(B) of the Sixth Directive to the services rendered by SWIFT and examined in *Nordea* (Case C-350/10[9]).

SWIFT is described as a cooperative society owned jointly by more than 2,000 financial institutions in the world that:

> manages a worldwide electronic messaging service for financial institutions ('swift services') which enables more than 9,000 banks and financial and securities management institutions and other corporate clients to exchange between themselves standardised financial messages with the help of software developed by the undertaking itself and its international secure data exchange network.
>
> By way of that data exchange network which it set up and maintains, SWIFT processes in particular messages concerning interbank payments and transactions in securities. The financial institutions affiliated to SWIFT are connected to the network by their own computer systems through a special gateway. In order to access its services SWIFT requires its clients to use computer hardware it has approved in advance.

On the basis of the details reported above, the ECJ came to the conclusion that the SWIFT services could not be covered by the mentioned provision of the Sixth Directive granting the exemption to financial services since, by being basically electronic messaging services for financial institutions, they did not meet the criteria established in the *SDC* case to ascertain if they, "viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of the financial transactions" related to interbank payments or transactions in securities.

The ECJ stated that (i) the supply of those services was not capable of giving rise to changes in the legal and financial situation of the recipients; and (ii) SWIFT's responsibility towards its clients was limited to technical aspects and did not extend to the specific and essential aspects of those financial transactions. In the end, SWIFT services were considered taxable for VAT purposes.

3. The Italian Tax Authorities' Approach to the Exempt Financial Services, in Line with the *SDC* Case

The *SDC* case has largely influenced the Italian approach to the exemption of financial services by the Italian tax authorities, as appears from some of their interpretation documents issued in this respect, briefly summarized below.

Resolution Letter 205 of 10 December 2001

In Resolution Letter 205/2001,[10] an Italian company operating in the sector of telematic services had asked whether the exemption granted to financial services (based on article 10 of the VAT Decree) was applicable to a series of operations it provided to a bank group. When examining the matter, the Italian tax authorities referred to the principles stated in the *SDC* case, pointing out the irrelevance of the person of the supplier (excluding, in particular, the need for the supplier to be a certain kind of financial institution or legal person) and of the manner, electronic or manual, in which the operations are provided, so that the services rendered by a data-handling centre in principle can also be exempt.

5. *SDC* (case C-2/95), paras. 32, 37 and 59.
6. It has also been stated that "the mere fact that a constituent element is essential for completing an exempt transaction does not warrant the conclusion that the service which that element represents is exempt" (SDC (case C-2/95), para. 65).
7. SDC (case C-2/95), para. 66.
8. Id.
9. FI: ECJ, 28 July 2011, Case C-350/10, *Nordea Pankki Suomi Oyj*, Case Law IBFD (accessed 20 Apr. 2021).
10. A Resolution Letter is an administrative decision issued by the Italian tax authorities, containing their opinion on a specific case submitted to them by a taxpayer. It is binding for the Italian tax authorities but not for the taxpayer (who may or may not adapt to their opinion – if it does not, it will risk penalties in case of an audit). Even if referred to a single specific case, of course a Resolution Letter can be assumed as expressing the opinion of the Italian tax authorities also in similar cases, and so it can be of general use to taxable persons.

Coming back to the above-mentioned specific criteria established in the *SDC* case for a transaction to be exempt, and related to the changing of the legal and financial positions of the recipients and to the level of responsibility of the supplier (the *SDC* case criteria), the Italian tax authorities specified that:

> decisive, for this purpose, will be the analysis of the level of contractual responsibility of the data centre towards the banks (i.e. its customers); it will be necessary, in fact, to evaluate whether such a responsibility is limited to the technical aspects of the supplied services or extends to the correct execution of the bank operations. In fact, it is very different the case where a supplier holds the central processing units and limits its activity to making them available to the banks – which use them through their own computers – from the case where the supplier of telematic services intervenes in the procedures of execution of the bank operations and directly perform them modifying the legal and economic situations and guaranteeing their correct execution. [Authors' translation.]

On the basis of the agreements in place, the supplier was responsible towards the banks (even up to 10% of its fees) for damages caused to third parties, in particular for those damages due to defaults of the banks deriving from defaults of the supplier in correctly executing the contractual transactions. In addition, the banks had the right to be indemnified in case of any legal actions threatened or brought by third parties against them for acts or omissions attributable to the supplier. Such a level of responsibility was much higher than the responsibility of a technical nature due to the simple making available of computer equipment and was connected to the circumstance that the services provided actual effects (modifying them) on the legal and economic situation of the recipients.

Based on all these considerations, the Italian tax authorities examined the different kinds of services performed by the data centre, acknowledging the exemption provided for financial services (with a couple of exceptions relating to operations considered as taxable since not expressly included within the scope of article 10 of the VAT Decree).

Resolution Letter 230 of 15 July 2002

In Resolution Letter 230/2002, the exemption was excluded with reference to the service of providing information (by elaborating an investment portfolio considered as optimal) to a company managing, on an individual and collective basis, portfolio investments for third parties. In this case, the exemption was denied, among other reasons, due to the lack of *SDC* case criteria (in addition, some relevant clarifications were rendered by the Italian tax authorities in respect to the "ancillary" nature of a service to another principal (or main) one, as will be better illustrated in section 4.1.).

Resolution Letter 133 of 13 June 2003

Resolution Letter 133/2003 referred to different services rendered by a company in relation to operations incurred between banks or between banks and subjects issuing credit or debit cards. The range of services included interbank payment services, services related to debit cards, services related to credit cards, innovative services (such as recharges of mobile phones) and access services (supply of the IT interface to operate on the national interbank network).

The Italian tax authorities, referring to their previous Resolution Letter 205/2001 and to the need for the *SDC* case criteria to be met in order to exempt the financial services under discussion, pointed out that, on a contractual basis, the supplier was responsible towards the banks (its customers) for the exact execution of the financial transactions, with regard to the "result" point of view ("the correct execution of the payment operations") and the "means" point of view ("the vehiculation of information in electronic format"). Such responsibility was general, being excluded only in cases of force majeure, i.e. when the defaults were generated by factors beyond the control of the company. At the end of their analysis, the Italian tax authorities concluded that the services could be classified into three categories:

- taxable services, with reference to those transactions not generating for the customer financial credit or debit exposures but characterized more simply for being a supply of telematic services (for example, the access services or the corporate banking);
- exempt services, in case the supplier's activity operated as a "common structure" to two or more subjects (banking and non-banking), financially interacting, with the aim of determining the specific credit/debit positions of the latter, and so having the typical nature of payment services (for example, interbanking payments with the exclusion of corporate banking, as seen in the first list item above); and
- services related to credit cards, where a distinction was made by the Italian tax authorities between the "processing" services, referred to payment transactions and so exempt, and other operations not specifically related to payments, and so taxable, e.g. the management of personal data (*gestione anagrafiche*) and the personalization of credit cards.

Resolution Letter 466 of 3 December 2008

Resolution Letter 466/2008 was also concerned with a company operating in the sector of telematic services supplied to banks and financial institutions. In particular, the supplier made available the hardware equipment, the software and the staff for the execution of the banking and financial transactions of its customer (a bank).

Again, based on the *SDC* case, considerable prominence was given by the Italian tax authorities to the level of responsibility of the supplier, which was much higher than the technical one related to the simple making available of IT equipment to a bank, and which extended to all damages for any reason caused by the supplier to the customer. The conclusion was that, from a general point of view, the services at hand could be assigned the exemption granted to financial transactions.

Resolution Letter 283 of 11 December 2009

In Resolution Letter 283/2009, a company operating as a service provider for banks had classified into different

categories the activities supplied to its customers (banks), identifying a specific VAT treatment (exemption or taxation) for each category on the basis of the past clarifications provided by the Italian tax authorities, and asked for confirmation that such VAT treatment was actually correct. Once again, the Italian tax authorities carried out their investigations on the basis of the *SDC* case and expressed their opinion that the taxable person had to identify the correct VAT treatment for each kind of service verifying, on a case-by-case basis, whether or not the *SDC* case criteria were actually met.[11]

Another relevant clarification provided by the Italian tax authorities in the Resolution Letter under discussion concerned the fact that certain services can be considered "ancillary" to the main exempt transaction and subject, upon certain conditions, pursuant to article 12 of the VAT Decree, to the same treatment provided for the main transaction. In section 4.1. the authors discuss this point, when examining how a transaction could be considered as "ancillary" to a main one, and so sharing the same VAT treatment.

Resolution Letter 375 of 17 September 2020

Resolution Letter 375/2020 confirmed the approach to the exemption of financial services followed by the Italian tax authorities in previous documents. Moreover, the examined scenario was similar to the ones already described, with a third party providing outsourcing services to a bank group. In addition, as a particular circumstance pointed out in the ruling, the supplier would have preliminarily purchased some going concerns from the bank group, containing the assets that would have allowed the former to carry on all the required transactions to the latter. The legal relationships with the final recipients (the customers of the bank group) would have remained within the headquarters of the bank group, even if the services had been actually performed by the outsourcer company.

The services at hand have been described as "banking back-office" services, including, among others, the "management of the administrative services of withdrawal and payment of cash and valuables, the management and processing of cheques, the management of wire transfers". In the opinion of the taxable person (the supplier) submitting the case to the attention of the Italian tax authorities, the services "were capable of directly affecting the legal sphere of the customers' final recipients of the service".

Again, the Italian tax authorities carried out their analysis on the possible exemption of the transactions submitted to them on the basis of ECJ case law, and in particular on that of the *SDC* case (and its case criteria). They affirmed that the third-party provider "charges and/or credits directly the sums on the holder's accounts through entries managed by means of digitized processes, thus modifying the legal and economic situation of the final customer of the bank, without requiring any intervention by the bank itself. The latter, in fact, only manages the archiving process of the documentation. Banking back-office services, including management of wire transfers, subject to tender, as represented by the applicant, therefore appear suitable for carrying out a transfer of funds as well as determining the legal and economic changes on the assets situations of the bank's customer, typical effects of financial transactions".

The contractual responsibility assumed by the supplier was the other crucial element that convinced the Italian tax authorities to recognize the financial nature of the examined transactions and to grant them the VAT-exempt treatment.[12]

4. A Possible New Approach Connected to the Growing Fragmentation and Complexity of Fintech Services

Historically, the outsourcing of some activities in the banking sector was a phenomenon involving one or more specific entities within the bank groups, supplying (for example, back-office) services to other entities of the same group.

In order not to penalize taxable persons operating in the banking sector, these activities were granted the exemption typical of financial transactions, considering that the customers would otherwise have borne the burden of VAT (which is always a cost, being not deductible for taxable persons carrying out financially exempt activities). This purpose has been achieved by granting the exemption, upon certain conditions, to the services supplied by consortia to their consortium members or partners with a very limited (not higher than 10% in the last three years) right to deduction of VAT.[13]

11. As regards the level of responsibility of the supplier, the Italian tax authorities expressed the opinion that a generic clause as the one contained in the agreement submitted to them in the ruling seemed to configure a limited responsibility, not consistent with the "high degree of responsibility" referred to by the *SDC* case, also considering the lack, in the same agreement, of a precise reference to the right of a subject "to be indemnified or held unharmed from damages and reasonable defence costs arising from actions brought or threatened by third parties originating from breaches or offenses of the indemnified party"; such a right to be indemnified had been evaluated in previous Resolution Letters published by the Italian tax authorities as relevant in order to recognize the high level of responsibility required by the *SDC* case.

12. "From the submitted documentation, it also emerges that the applicant company, in addition to being responsible towards the client [i.e. the bank group – authors' note] for the failure to comply with the levels of supply of the BPO services in the contract and related attachments, it responds … for the damage caused to the various customers of the … bank group in the event of late and incorrect execution of the services. The level of responsibility that would be assigned to the service provider in case of legal actions by the final customers of the bank, as can be seen from the ruling, seems so to leave unharmed the credit institution that owns the relationship with the recipient of the service, within the limits of the insurance coverage identified in the policies stipulated by the applicant. Therefore, the degree of responsibility of the service provider is not limited to technical aspects, but extends to the specific and essential functions of the financial transactions …".

13. Art. 10(2) VAT Decree provides for the exemption of "[t]he services rendered to their consortium members or partners by consortia, including companies consortiums and cooperatives with consortium functions, set up between subjects for which, in the previous three calendar years, the percentage of deduction referred to in Article 19-bis, also as a result of the option referred to in article 36-bis, was not more than 10 percent, provided that the fees due by the consortium members or members to the aforementioned consortia and companies do not exceed the costs attributable to the services themselves".

Another instrument provided for more recently by the Italian VAT legislation (implementing the VAT Directive) in order not to penalize taxable persons operating in the banking sector (where any incurred VAT, as seen, is always a cost), has been the possibility to opt for the setting-up of a "VAT group",[14] provided that specific requirements are met by the companies of the group.

The advantage here is represented by the fact that the transactions (supplies of goods or services) carried out between two members of the same VAT group are outside the scope of Italian VAT, and so, in case of transactions that as a general rule would be taxable (for example, consultancy or the making available of IT equipment to another member of the VAT group), the same would actually be charged without VAT.

In addition to the question whether financial transactions between persons are legally or economically linked as members of a bank consortium or of a bank VAT group, from a general point of view, Resolution Letter 375/2020 is relevant because, beside confirming the past interpretations provided by the Italian tax authorities over the last 20 years, it specifically refers to a situation where the bank does not separate core activities in favour of third parties that then use the acquired assets in order to provide financial services to the same bank.

This could be a quite common situation in the current economic scenario, characterized by an increasing fragmentation and complexity of fintech services. In all such cases, where the *SDC* case criteria are respected, the exemption for financial services could be granted, so obtaining the same results as the ones granted by specific Italian VAT provisions (related to banking consortia and the VAT group) for the hypothesis of outsourcing of the same activities.

In other cases where the *SDC* case criteria were not applicable for any reason (for example, if the responsibility of the supplier is limited to the technical aspects of the services, guaranteeing only the correct "working" of the equipment made available to a bank but not also guaranteeing the correct "execution" of the financial transactions), services (which are in principle taxable) provided by the supplier could be granted exempt treatment again due to particular circumstances in which a close link exists between two transactions. This is dealt with in sections 4.1. and 4.2., which describe "ancillary" services and "single supplies".

4.1. Services "ancillary" to exempt financial transactions

Where services that, on their own, would be taxable (for example, the making available of IT equipment) are acquired through outsourcing by a bank or a financial institution in order to carry out exempt financial transactions, it would be relevant to check whether such services can be considered "ancillary" to a main financial service carried out by the bank or financial institution, since in such a case the ancillary services would not have a separate and autonomous VAT treatment (i.e. taxation), but would rather be subject to the VAT treatment (i.e. exemption) of the main financial transaction to which they relate.

The relevant EU provision here is article 78 of the VAT Directive, providing that:

> The taxable basis must include the following elements:
>
> …
>
> (b) ancillary costs, such as commission, packaging, transport and insurance charged by the supplier to the buyer or to the recipient of the service.
>
> For the purposes of the first paragraph, letter (b), the expenses subject to a separate convention *can* be considered by member states as ancillary costs. [Authors' translation.]

The provision contained in the second paragraph of this article 78 (related to the ancillary nature of the expenses subject to a separate convention) has not been expressly implemented in the text of the corresponding Italian rule (article 12 of the VAT Decree), which provides that:

> The transport, the installation, the packing, the packaging, the supply of containers and other supplies or services ancillary to a supply of goods or services, carried out *directly by the transferor or supplier or on his behalf and at its expenses*, are not autonomously subject to tax in relations between the parts of the main operation. If the main supply is subject to tax, the considerations for the taxable ancillary supplies of goods or services are included in the taxable basis. [Authors' translation, emphasis added.]

When reviewing the VAT treatment of ancillary services, it must be pointed out that the ECJ approach has always been more flexible than the one taken by the Italian tax authorities.

Having specified that "[a] service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied" (*Card Protection Plan* (Case C-349/96[15]), in *Commission v. France* (Case C-76/99[16])) the ECJ established a very relevant principle, not immediately related to ancillary services but to activities "closely related" to the "hospital and medical care" that are exempt (reference was made to article 13(A)(1)(b) of the Sixth Directive, now article 132(1)(b) of the VAT Directive).

Commission v. France concerned the VAT treatment of laboratory analysis; in particular, according to the French VAT legislation:

- a laboratory (here defined as "A"), taking from a patient ("B") medical samples to be then examined by another laboratory ("C"), invoiced the sample-taking to the patient as VAT exempt;
- C also invoiced the analysis of the sample to the patient as VAT exempt; and
- the fee for the transmission of the sample from A to C was subject to VAT and not exempt, and that was the reason why the case was submitted to the ECJ.

14. "VAT groups" are regulated by art. 70-*bis* et seq. VAT Decree.

15. UK: ECJ, 25 Feb. 1999, Case C-349/96, *Card Protection Plan Ltd v. Commissioners of Customs and Excise*, para. 30, Case Law IBFD (accessed 20 Apr. 2021).

16. FR: ECJ, 11 Jan. 2001, Case C-76/99, *Commission of the European Communities v. the French Republic*, Case Law IBFD (accessed 20 Apr. 2021).

In this case, the ECJ stated (in paragraph 24):

> For the purpose of any possible exemption from VAT for the act of transmitting medical samples, it is appropriate to have regard to the purpose for which those samples are taken … the transmission of the sample, which logically takes place between the taking of the sample and the analysis itself, must be regarded as closely related to the analysis and must therefore be exempt from VAT.

Moreover, having referred (in paragraph 27) to the requirements for a service to be ancillary to a principal one on the basis of the *Card Protection Plan* case, the ECJ recognized (in paragraph 28) the following:

> In the present case, the patient is indifferent as to whether the laboratory which takes the sample also carries out the analysis, or subcontracts it to another laboratory but remains responsible to him for the analysis, or, because of the nature of the analysis at issue, is obliged to send the sample to a specialised laboratory. The obligation, in the last case, to send the sample to a specialised laboratory arises from the need to ensure for the patient that the analysis is as reliable as possible …

Therefore the ECJ concluded in paragraph 30:

> In those circumstances, the taking of the sample and the transmission of the sample to a specialized laboratory constitute services which are closely related to the analysis, so that they must be treated in the same way as the analysis for fiscal purposes and, accordingly, must not be subject to VAT. [Emphasis added.]

Commission v. France is relevant because the principle was established according to which a service can be considered "closely related" or, in general (which is the same from a practical point of view), ancillary to another (the principal, or the main one) not only if they share the same supplier, but also if the supplier of the main service is different to the supplier of the ancillary one. This was valid in the case under discussion, where C rendered exempt services to B, and such exemption was considered as the treatment to be extended to the ("closely related") transmission service provided by A to C.

In the Resolution Letters mentioned below, the Italian tax authorities have specified the requirements that have to be met, in their view, for an ancillary relationship to be identified between two services.

In this respect, the previously mentioned Resolution Letter 230/2002 was related, as said, to the service of providing information (by elaborating an investment portfolio considered as optimal) to a company managing, on an individual and collective basis, portfolio investments on behalf of third parties. In this Resolution Letter it was affirmed that:

> it is not enough for the first [the providing of information, that is the supply of service deemed ancillary to the other – authors' note] to ensure a generic utility to the activity, considered as a whole, put in place by the supplier who carries out the main operation (or operations). *It is necessary that the ancillary service forms a whole with the main operation, and not only that the latter is made possible or easier by the execution of the ancillary service* … . [Authors' translation, emphasis added.]

The same concept was also affirmed with Resolution 6 of 11 February 1998 of the former Revenue Department, in which the administration specified that:

> it is necessary in particular that the ancillary services are carried out precisely due to the fact that there is a main service, in combination with which they can lead to a certain desired result. Conclusively *only the transactions carried out by the same subject in necessary connection with the main operation to which, therefore, they refer are ancillary and which have, as a rule, the function of integrating, completing or making possible the said main supply.* In the present case, however, the service qualified as ancillary is made by a third party, with whom the final customers of the applicant taxpayer do not have any relationship, and the same service does not appear intended to supplement or complete, in the sense specified above, the operation made to the end customer. [Authors' translation, emphasis added.]

It is interesting to note that Resolution Letter 230/2002, mentioned previously, referred to *Commission v. France*, but excluded the application of the principle deducible from it (i.e. the possibility for a service to be ancillary to another – and so to share the same VAT treatment – even if they have different suppliers) due to the fact that the service provided by the third supplier did not appear to be intended

> to "integrate, complete or make possible" a specific service performed in favour of *a particular customer* of the KW [i.e. the company managing, on an individual and collective basis, portfolio investments on behalf of its customers – authors' note], but assumes rather generic outlines in relation to the whole activity, considered as a whole, of the same company. [Authors' translation, emphasis added.]

In line with the same narrow approach, in the previously mentioned Resolution Letter 283/2009, the Italian tax authorities stated that, in order for an ancillary relationship to exist:

> … it is necessary that the ancillary transaction takes place between the same parties of the main transaction and that is put in place by the supplier, or by a third party but on his behalf and at his expense, provided that the ancillary service constitutes "the means for enjoying the main service under the best conditions".
>
> It is not possible, on the other hand, to consider as 'ancillary' to another an operation that takes place between subjects other than those of the main one, or the operations that pursue an autonomous and different purpose from the one that connotes the main operation, even if preparatory or connected to the latter. [Authors' translation.]

Fortunately, a relevant and more flexible approach in this respect has been expressed by the Italian Supreme Court (*Corte di Cassazione*), in its Judgment 351/2019,[17] related to the VAT treatment of a consulting service rendered to an Italian company that had acquired a participation by a supplier different from the seller of the participation. The question was whether a supply of service normally taxable for VAT purposes (a consulting service) could benefit from the exemption due to its strict "connection" with the sale of a participation, which is an exempt transaction.

The Italian Supreme Court first of all pointed out the difference between ECJ case law, which "would disregard the subjective identity between whoever carried out the main transaction and whoever carried out that 'ancillary' one"

17. IT: SC, 9 Jan. 2019, 351/2019, *Atlas Copco Italia S.p.A. v. Italian Tax Administration.*

and the domestic practice, "which considers at the most that the 'ancillary' operation can also be carried out by a third party on behalf of who carried out the main transaction …", before remarking that the objective aspect to be held as characterizing the "ancillary" nature of the operation "is that of *its unitarity declined under different profiles such as for example that of the nexus of instrumentality or that of dependence* etc.". The Italian Supreme Court has further specified that "what actually matters is that *the only operation is not artificially divided*, what would occur when several operations actually constitute a whole single, i.e. when *the 'ancillary' transaction would not have been carried out if the main one had not been carried out*, with the consequence that *both must be considered functionally connected to obtain the same identical good or the same identical service* …". [Authors' translation, emphasis added.]

In the end, considering that (i) according to the ECJ case law (in particular reference was made to the *Commission v. France*) "the transaction may be 'ancillary' even if not directly carried out by the subject who carried out the main transaction or for account of it", and (ii) the consultancy was carried out "on the occasion of the sale of the shareholdings", the Italian Supreme Court has recognized the objectively "ancillary" nature of the consulting service in respect of the main transaction (the transfer of the participation), so that the former had to correctly share also the VAT-exempt treatment of the latter.

All the above considerations in terms of ancillary services could be helpful in order to support, in the financial sector, the exempt treatment of a service that in itself could be taxable (for example, a consultancy), but which could be treated as exempt if considered ancillary to a main financial transaction based on the illustrated criteria. For the sake of clarity, these criteria basically are (i) the fact not to have an aim in itself, different from the one of the main transaction, but to be the means of better enjoying the main transaction; (ii) the circumstance that the ancillary service would not be supplied should the main service not be supplied as well; (iii) the relationship of instrumentality and dependence of the ancillary service vis-à-vis the main one.

Moreover, such conclusions would be valid not only if the ancillary service is rendered (i.e. provided and invoiced – *Commission v. France*) to the supplier of the main service (for example, a bank carrying out financial transactions, exempt according to the *SDC* case criteria), but also if it is rendered (provided and invoiced) to the same recipient of the main service (for example, a customer of the bank), as was the case in Judgment 351/2019 of the Italian Supreme Court.

4.2. Separate services or single supply?

Connected to the matter of ancillary services is the issue related to the need to verify, in the presence of more supplies, whether the latter must be separately treated from a VAT point of view or on the contrary, under certain circumstances, they can be held as "constituting" a "single supply" with its own and specific VAT treatment.

This matter was accurately examined by the ECJ in *Levob* (Case C-41/04),[18] where relevant principles were established:[19]

> … where a transaction comprises a bundle of features and acts, *regard must be had to all the circumstances* in which the transaction in question takes place in order *to determine*, firstly, *if there were two or more distinct supplies or one single supply* and, secondly, whether, in the latter case, that single supply is to be regarded as a supply of services …[20]
>
> Taking into account, firstly, … that every transaction must normally be regarded as distinct and independent and, secondly, that *a transaction which comprises a single supply from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system*, *the essential features of the transaction must* in the first place *be ascertained in order to determine whether the taxable person is making to the customer, being a typical consumer, several distinct principal supplies or a single supply* …[21]
>
> … there is a *single supply* in particular in cases where *one or more elements are to be regarded as constituting the principal supply*, whilst *one or more elements are to be regarded*, by contrast, *as ancillary supplies* which share the tax treatment of the principal supply …[22]
>
> The same is true where *two or more elements or acts supplied* by the taxable person to the customer, being a typical consumer, *are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split*.[23] [Emphasis added.]

The ECJ has also specified that, if on the basis of the mentioned circumstances a "single supply" should be identified, then the conclusion would not be affected by the fact that separate prices have been contractually foreseen for the different elements constituting such a single supply.[24]

The matter at hand has also been evaluated by the Italian tax authorities.

In Resolution Letter 153/2002 (referred to by the subsequent Resolution Letter 267/2002), the tax authorities stated that any specific case must be examined in order to ascertain, on the basis of the contractual agreements, whether the different activities rendered by a supplier have to be considered as autonomous supplies of services or, otherwise, as "internal activities, instrumental to the final result". In the latter hypothesis, "the separate evidence on the invoice of the single activities making up the complex supply is relevant only for identifying the elements which said supply is made of", and not also to determine the VAT treatment of each of these elements, since

18. NL: ECJ, 27 Oct. 2005, Case C-41/04, *Levob Verzekeringen B.V, OB Bank N.V, v. Staatssecretaris van Financiën*, Case Law IBFD (accessed 20 Apr. 2021).
19. The ECJ reaffirmed the same principles on many occasions, e.g. in SE: ECJ, 29 Mar. 2007, Case C-111/05, *Aktiebolaget NN v. Skatteverket*, Case Law IBFD; IT: ECJ, 21 Feb. 2008, Case C-425/06, *Part Service, Ministero dell'Economia e delle Finanze, formerly Ministero delle Finanze v. Part Service Srl, company in liquidation, formerly Italservice Srl*, Case Law IBFD; and DE: ECJ, 19 July 2012, Case C-44/11, *Finanzamt Frankfurt am Main V-Höchst v. Deutsche Bank AG*, Case Law IBFD.
20. *Levob* (C-41/04), para. 19.
21. Id., para. 20.
22. Id., para. 21.
23. Id., para. 22.
24. Id., para. 25.

the "single supply" as a whole would be subject to its own correct VAT treatment.

In their Reply 372 of 17 September 2020 to a specific ruling, the Italian tax authorities, referring to the ECJ case law, specified that a "single operation" (or supply) can be seen for VAT purposes to exist when such operation is composed of:

> (i) two or more elements or acts of the same taxable person which are so closely linked as to form, objectively, a single economic indissociable operation whose decomposition would have an artificial character …; (ii) one or more services that constitute the main service, while one or more other services constitute an ancillary service or more ancillary services subject to the same tax treatment as the main service. … several formally distinct services, which could be provided separately and thus give rise, separately, to taxation or exemption, they must, in fact, be considered as a single transaction when not independent …. In order to determine whether the services provided constitute multiple independent services or a single service, it is necessary on the one hand to identify the elements characteristic of the complex transaction …, on the other hand, to take into account the economic objective of this economic transaction. [Authors' translation, emphasis added.]

From the principles established by the ECJ and reaffirmed by the Italian tax authorities, it is clear that the same aim (i.e. of identifying a sole correct VAT treatment in the presence of different supplies of services to be considered as a whole from an economic point of view) can be reached two ways. These are either (i) when a main service "attracts" one (or more) ancillary service(s), which consequently are subject to the same VAT treatment of the former, or (ii) when it is not possible, considering all the circumstances, to identify a supply (the ancillary one) subordinated to or dependent on the other (the main one) but both of them are so closely linked as to form a single complex transaction that can only be artificially broken down into single elements.

In the case of a single (complex) supply, one possibility in the future of financial transactions (from a legal or from a case law point of view) could be to consider that a single VAT treatment (of the single complex transaction) could be applicable even if the single services that it is composed of are rendered by different subjects, provided that considered collectively such services allow supplying a transaction subject to its own and specifically identified VAT treatment.

Back to the *SDC* case principles, the result of such an approach could be that if a financial transaction is obtained through the linked and strictly coordinated activities of two subjects that, *jointly*, ensure the *SDC* case criteria are met (thus enabling the change in the legal and financial situations of the recipient, and assuming they have, separately or at least jointly, a high level of responsibility related to the correct execution of service), the single service rendered by each supplier could lose its autonomy and individuality, since such services should be considered together to form a "single supply". At this point, should they "viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions" of a financial transaction, the exemption could be granted to each of the single supplies, which together would form a single complex financial transaction that is VAT exempt.

A recent document issued by the Italian tax authorities (Reply 214 of 26 March 2021 to a specific ruling) could help in supporting such a view. It refers to an Italian company (ALFA) carrying out payment services to customers operating in several sectors (hotels, gyms, etc., hereinafter the merchants) and with the goal to propose a new "payment collection service" to its customers, using a business partner (BETA) that will provide the service of "payment (by cards or current account) acceptance".

For any transaction, after the merchant's debtor has chosen the method of payment, ALFA, operating as the collection agent (*mandatario all'incasso*), will execute the collection of the payments (on behalf of the merchant) through BETA, which will process the payments authorized by the merchant's customers and will pay the due amounts to an omnibus current account owned by ALFA.[25] Then ALFA will transfer the cashed amounts from the omnibus current account to the single current account specified by the merchant.

BETA being an EU company, with the ruling at hand, ALFA had asked the Italian tax authorities for the correct treatment of BETA's services, since its place of supply was in Italy (i.e. the customer's – ALFA's – country of establishment). The Italian tax authorities, having referred again to ECJ case law and in particular to the *SDC* case, decided that:

> the transfer of the sums involved in each payment order from the merchant's debtor/end customer to the merchant itself occurs at the outcome of the processing activities carried out by BETA and at the same time as they are credited to the omnibus account headed to ALFA. In this regard, it is believed that the commissions that the applicant company [i.e. ALFA – authors' note] pays to BETA, therefore, remunerate telematic services of management of payments qualifying as acquiring services and services of processing, on the tax treatment of which the Revenue Agency already expressed its opinion with resolution no. 354/ E of 2007 considering them as subjects to the VAT exemption regime. Therefore, on the basis of what was declared by

25. As stated in Reply 214: "In particular … the activity of BETA allows the transfer of funds only between parties involved in the underlying economic transactions, generating debit or credit financial exposures, capable of affecting the legal sphere of the subjects which they are addressed to, carrying out the payment management activity (of which ALFA is the collection agent). … ALFA instructs BETA (as acquirer) to direct, receive, transmit and pay the funds due. The funds subject to the payment provisions and to the processing services to be provided by BETA are never owned by BETA, as it acts as an acquirer. The transfer of the sums covered by each provision of payment from the merchant's debtor/final customer to the merchant occurs at the end of the processing activities carried out by BETA and at the same time as they are credited to the omnibus account owned by ALFA. … Commissions relating to the services provided by ALFA to its customers will also include those due to BETA. The payment of commissions will take place by charging the sums due to customers.
In particular, the flow of commissions can be summarized as follows:
– BETA will process/transfer the money from ALFA's technical account activated at BETA to the Omnibus Account, net of the commissions due to BETA (expressly instructed by ALFA to make the aforementioned deductions);
– the sums credited to the Omnibus Account will be in turn credited to the merchant's current account net of all commissions chargeable under the contract stipulated between the merchants and ALFA."

> the applicant, in the assumption that the services provided by BETA are suitable, within the aforementioned terms, to generate for the subjects involved in the underlying economic transactions financial credit or debit exposures producing the typical effects of 'financial' transactions, as identified by the EU and national legislation, able to affect the legal and economic sphere of the subjects they are addressed to, the VAT exemption regime as per art. 10, first paragraph, (1), of the Presidential Decree n. 633 of 1972 is considered applicable... . [Authors' translation.]

It should be noted that, as regards the supplies of services carried out by ALFA to its customers, the Reply under discussion specifies that they are exempt according to article 10 of the VAT Decree (since no distinction is made in this respect, reference can be made not only to the already provided services but also to the new "payment collection service", which is the subject of the ruling).

This recent Reply rendered by the Italian tax authorities is relevant due to the fact that a complex financial service (the payment collection service supplied by ALFA to the merchants), exempt from VAT, involved two different suppliers (ALFA and BETA, for the respective activities) and both the supplies were considered exempt since they met the requirements provided for by the *SDC* case.[26]

5. Conclusions

The *SDC* case established the fundamental pillars for correctly qualifying transactions (in particular, those "related to payments") as "financial", thereby making them exempt from VAT, according to the Sixth Directive (and then according to the VAT Directive, considering that the principles expressed in such a "pilot" judgment have been reiterated by the ECJ over time).

The Italian tax authorities have shared and applied on different occasions the principles stated in the *SDC* case, thereby allowing players in the financial sector not to bear the cost of VAT (typically, banks receiving from third-party providers services that met the requirements to be classified as "financial" and so exempt for VAT purposes).

The exemption, as seen, has been deemed applicable by the Italian tax authorities even if the final recipients of the financial services (typically, services related to payments such as the transfers of funds), i.e. the persons whose *legal and economic situations were changed* as an effect of the services themselves, had no legal relationship with the service provider (for example a data-handling centre) but only with their bank (which, in its turn, was the contractual party of such a service provider).

The possibility to grant the exemption on the basis of the "ancillary" principle was then examined, where a service that in itself would be taxable (due to its non-financial nature) could be "attracted" to the exemption regime of another, since the former is to be considered "ancillary" (as defined by the ECJ and/or the Italian tax authorities or the Italian Supreme Court) to the other, the main one. In this respect, from an Italian point of view, a relevant result of the last years is the principle – established sharing the ECJ approach – that the "ancillary" link can be established not only where the main service and the ancillary one are rendered by the same subject, but also in the presence of different suppliers (that could be the case, for example, with a consultancy strictly connected with the performing of a financial transaction, whose exemption would attract the consultancy).

The matter of the "single supplies" was also explored, where it is not possible to find a dependence or subordination relationship between a service (the ancillary one) and another (the main one), but all the elements composing the transaction are in any case so closely linked to each other that the "single (from an economic point of view) supply" can only be split artificially into different transactions, each with its own (taxable or exempt) VAT treatment.

From a case law and/or legal perspective (also in the light of possible future changes to the VAT treatment of the financial services, as currently evaluated at an EU level), it could be possible to consider that the "single supply", even if the constituting transactions are provided by different suppliers, forms "a distinct whole having the effect of transferring funds and entail[ing] changes in the legal and financial situation" (of the recipients). This would be exempt, with the consequences that the exemption could/should apply to all the single activities or services (outsourced out of the bank or the financial institution involved) of which the "single supply" is composed.

To conclude, in the case of ancillary services to main ones and of "single supplies", what has to be investigated is the real economic aim of the customer, i.e. the final result pursued when acquiring a (unique) financial transaction. When different "components" of the service are so closely linked to form a unique whole for which the level of responsibility provided for by the *SDC* case is respected, even if from a collective point of view (meaning that, in the case of different suppliers of the different "component" services, all of them would be collectively responsible for ensuring the correct execution of the financial transaction) a possible solution could be to make the financial transaction exempt as a whole as well as the single components constituting it, even if rendered by different suppliers. The recent Reply 214/2021, as seen above, would seem to offer arguments that support such conclusions.

26. The relevance of the *SDC* case criteria has been expressly acknowledged for the transactions carried out by BETA but is surely indirectly confirmed also for the service supplied by ALFA (the overall "payment collection service" provided to the merchants through both the services supplied by BETA and the final transfers from the omnibus current account to the merchant's single current account, carried out by ALFA), since otherwise they could not be exempt according to art. 10 VAT Decree, as it is stated in the Reply under discussion.