UPDATE

Digital payment services: the timeless question of the correct VAT treatment & new reporting challenges

A key area linked to the unprecedented boost of e-commerce is obviously the digital payment of goods and services ordered online. This industry experienced a massive transformation going from traditional banks to the development of Fintech companies.

From a VAT standpoint, the treatment of payment services may look simple at first sight since the VAT legislation includes a specific exemption for payments and transfers under Article 135(1)(d) of Directive 2006/112/EC (the "VAT Directive"). Nevertheless, in practice the scope and applicability of this exemption is far from obvious and has been the topic of numerous cases of the Court of Justice of the European Union (CJEU).

Given the impact on the global marketplace, the EU Commission launched discussions with the EU VAT Committee on VAT implications arising from the digitalization of the payment sector in the context of e-commerce in order to promote a uniform application of the VAT provisions regarding common business models. This resulted in VAT committee guidelines adopted in April 2023.

In the meantime, payment service providers ("PSPs") face new VAT challenges. As from 1st January 2024, they shall comply with the new recordkeeping and reporting obligations introduced by the EU Council Directive (EU) 2020/284 ("EU Payment Services Directive") where cross-border payments relating to e-commerce transactions originate from EU Member States (MS). Considering the importance of the information held by PSPs, the new rules aim to give the tax authorities greater insight into cross-border payments to help them detect and prevent VAT fraud.

This paper provides you with the view of the VAT Committee on the VAT treatment applicable to common business models of the payment sector as well as with key takeaways regarding the new VAT reporting obligations.

Financial exemptions related to payment services

Under Article 135(1)(d) VAT Directive MS are required to exempt transactions – including negotiation – concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection.

Whether services are within the scope of this provision must be assessed by looking at the nature of the services. It is not relevant whether the person providing the service is a bank or credit institution or a different person. The means by which a service is provided is likewise not relevant. Both manually, automatically and electronically provided services can be within scope of the exemption.

The CJEU has ruled that a transfer of money is characterized by a change in the legal and financial situation existing between the person giving the order and the recipient and between those parties and their respective banks and in some cases between

the banks. Furthermore, the CJEU has clarified that an exempt service must be distinguished from a mere physical or technical supply and therefore it is necessary to examine the extent of a provider's responsibility towards its customers, i.e. whether its responsibility is restricted to technical aspects or whether it extends to the specific, essential aspects of the exempt transactions.

In case of bundling of services, the CJEU reminded on various occasions that is necessary to assess on a case-by-case basis whether these other services are ancillary to a principal payment service exempt of VAT, as a means for better enjoying it, or so closely linked to it that they form, objectively, a single, indivisible economic supply, which would be artificial to split. These two criteria suffice to show the complexity of the matter in an industry where the supply chain is fragmented for sake of efficiency and client satisfaction.

E-wallets

E-wallets simplify payments for both sellers and customers. They allow sellers to accept several payment methods and in turn the customers to make use of these payment methods. In order to use e-wallets, both customer and seller need to register with an e-wallet provider and hold an account there. In the e-wallet chosen payment methods are stored and possibly also shipping information. A payment process using an e-wallet consists of several steps that are schematically discussed below (figure 1).

Typically, wallet providers charge fees to sellers and (certain fees) to customers as consideration for services provided. Therefore e-wallet providers will be regarded as taxable persons for VAT making taxable supplies. Whether their services are exempt payment services must be assessed under Article 135 (1)(d) VAT Directive.

According to the VAT Committee, and we agree with that view, the e-wallet provider performs the actual transfer of funds and therefore fees paid for this activity will be exempt from VAT. Where the e-wallet provider provides additional services such as management dashboard services and site integration services it must be established whether those services are ancillary to the principal payment service. If that is the case, the service is exempt from VAT. However, if they constitute a separate service, they will be subject to VAT.

Pass through wallets only allow customers to store their payment and shipping information. Services provided by pass through wallet providers are not exempt from VAT, because there is only an administrative service.

Marketplaces and intermediaries collecting funds in their own name

Marketplaces and specialized intermediaries/fintech companies integrate innovative payment services in their non-financial offerings and enable their clients (i.e. merchants) to accept various payment methods from the final consumers for the services/goods supplied. The most prominent value-added feature of these payment solutions is that the merchants can get access to the multiple payment schemes (such as credit cards) without the need to deal with and register to each one of them. They simply have to create a merchant account with the marketplaces/intermediaries. A typical example of a card payment to a marketplace consists of several steps that are schematically discussed (figure 2).

In return for the services provided, marketplaces charge a fee to the merchant that is deducted at the time the collected funds are transferred by the bank to him. Therefore, marketplaces will be regarded as taxable persons for VAT making taxable supplies.

Figure 1: A payment process using an e-wallet

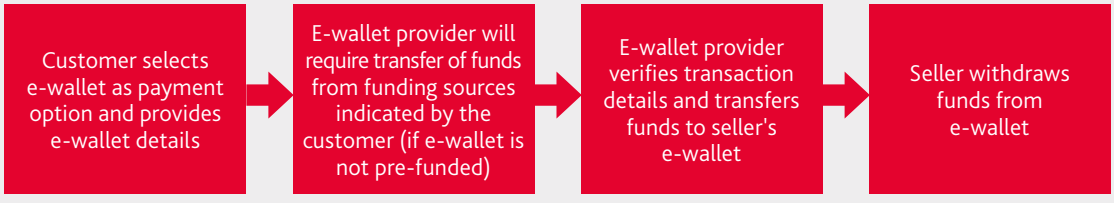
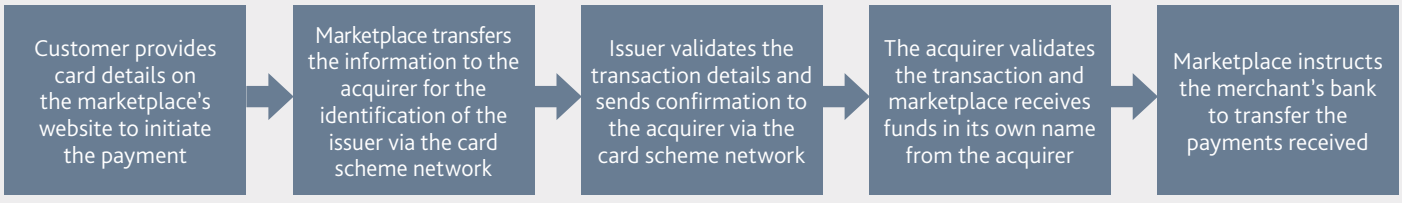


Figure 2: An example of a card payment to a marketplace



Where the payment solutions offered by the marketplaces might be embedded within other non-financial supplies, it is required to verify whether these payment solutions could be regarded as ancillary to a principal service (e.g. supply of marketplace hosting and facilitation service). If that is the case, the service is subject to VAT. However, if they constitute a separate service, it should be assessed on a case-by-case basis whether they could benefit from the VAT exemption of Article 135(1)(d) VAT Directive.

According to the European Commission, for merchants the possibility to offer different payment methods would most probably constitute an aim in itself, separate from the ordinary services purchased from the marketplaces, and thus the two supplies should be treated separately for VAT purposes. The VAT committee has not taken a position on this.

In this respect, the VAT Comittee finds, and we agree with that view, that the marketplace does not perform the actual transfer of the funds but requests the relevant financial institutions to carry out those transfers. Hence, the legal and financial situation of the payer and payee are not affected by the marketplace. Therefore, fees paid for such an administrative service shall be subject to VAT.

Particular attention should also be paid on whether the services provided by the marketplaces could qualify as debt collection and thus be directly excluded from the scope of the VAT exemption. As this concept has been interpreted by the CJEU broadly, a case-by-case assessment is needed.

Buy now pay later offerings

Buy now pay later offerings are deferred payment schemes that were previously offered with regard to high value items, such as cars. However, nowadays they are also available for other types of goods, such as clothing.

A buy now pay later offering typically includes three agreements: i) an agreement between the buy now pay later provider and the seller, ii) an agreement between the buy now pay later provider and the seller's customer and iii) an agreement between the seller and its customer. Under the agreement between the buy now pay later provider and the customer, the latter instructs the provider to pay the amount of its purchase to the seller, whereby the customer agrees to pay the amount back according to the terms set by the provider.

Under the buy now pay later offering it is the seller that pays a fee to the provider, whereas the customer typically pays no interest on its loan.

According to the European Commission, the fee owed by the seller to the provider is to be regarded as a single supply consisting of both advance funding and the recovery and collection of debts. Though advance funding (i.e. providing a loan) is exempt from VAT, the exemption does not apply to debt collection, which includes factoring services. Depending on the situation at hand the debt collection or advance funding could be the predominant element of the supply. If the latter is the predominant element, the service will be exempt from VAT. If the first is the predominant element of the supply, the service will be subject to VAT.

We agree with the European Commission's opinion that the buy now pay later offering constitutes a single service. We also agree with the position that it depends on the fact and circumstances of a particular buy now pay later scheme whether the service is exempt or subject to VAT. We tend, like the VAT committee, to take the position that the service will be exempt from VAT, because in our view the predominant element is the granting of credit by the provider to the customer for which the provider charges a fee to the seller (third party payment).

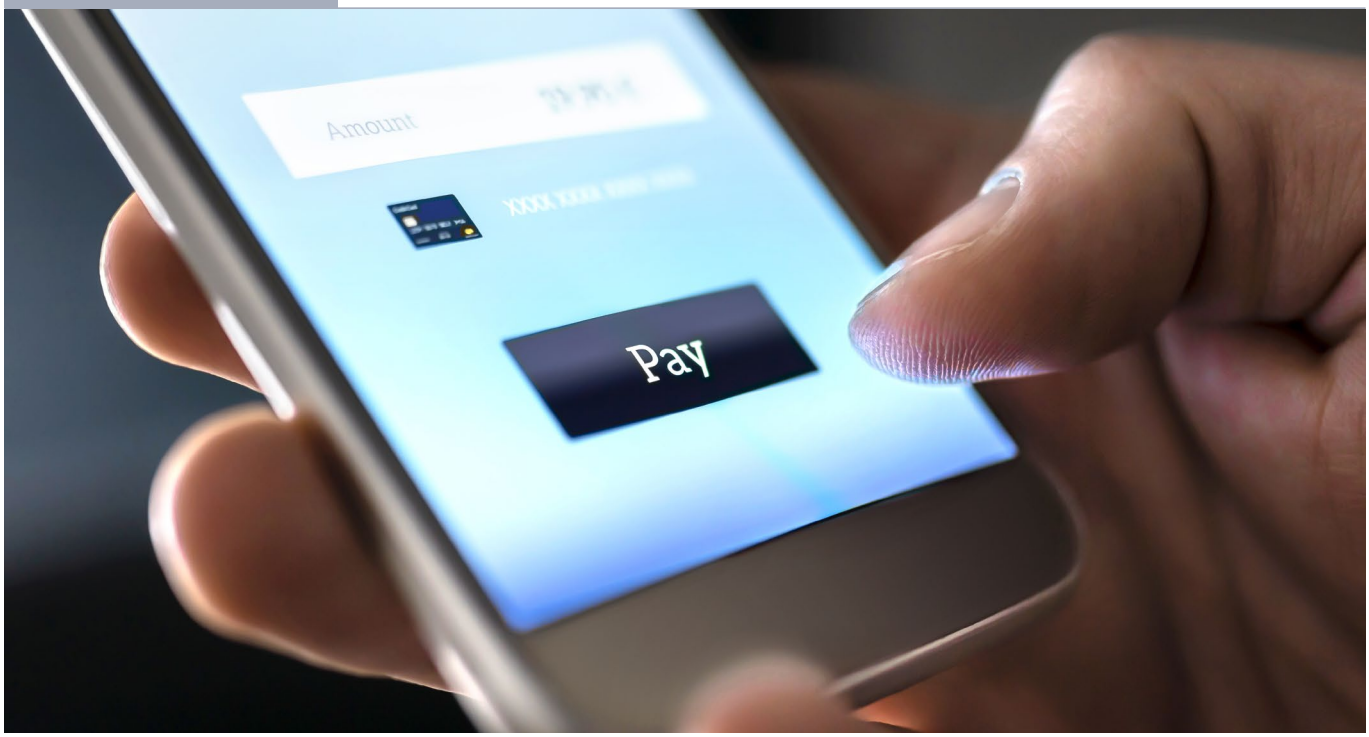
The new VAT information obligations for PSPs (starting from 1st January 2024)

The new rules of the EU Payment Services Directive for recordkeeping and reporting on cross-border payments apply to PSPs established in an EU MS, i.e. whose business identifier code (BIC) or unique business identifier refers to a MS. However, they may also apply to PSPs established in non-EU countries that are members of the European Economic Area (EEA), such as Iceland, Liechtenstein and Norway, when they provide payment services in an EU MS via a physical presence (e.g. branch, commercial agent) or even without it.

In fact, the scope of these provisions is quite broad and covers most of the payment market, i.e. credit institutions (e.g. licensed banks), e-money institutions (e.g. e-wallet and electronic vouchers providers), post-office giro institutions and payment institutions (e.g. issuers of credit/debt cards, platforms/marketplaces).

Nevertheless, only PSPs which provide the following payment services will be in scope of the reporting obligation: i) executing payment transactions and transfers of funds on payments accounts, ii) executing payment transactions covered by a credit line, iii) issuing of payment instruments and acquiring of payment transactions and iv) money remittance.

Another condition is that the payments qualify as cross-border within the meaning of the EU Payment Services Directive, i.e. they are payments from a payer in one EU MS to a payee in another EU MS/a payee located outside the EU. Furthermore, payment information only has to be recorded and provided if an EU or non-EU payee receives more than 25 payments per quarter.



Where the PSP of both the payee and the payer are located in a MS, only the payee's PSP will be required to keep records and comply with the reporting requirement. Where the payee's PSP is not located in a MS, the payer's PSP will be subject to such obligations. Penalties may be imposed by individual Member States if a PSP reports excessive information, e.g. when the PSP of the payer reports information when the reporting obligation only applies to payee's PSP in its respective MS.

For PSPs that fulfil the above conditions, the following information shall be recorded and reported:

- bank Identifier Code (BIC) or other business identifier code that clearly identifies the PSP;
- payee's name or business name;
- payee's VAT-ID/TIN or a national number used for tax purposes;
- IBAN of the payee's payment account or similar unique identification that unambiguously identifies and provides the location of the payee;
- BIC that unambiguously identifies and gives the location of the PSP acting on behalf of the payee, where the payee receives funds without having a payment account;
- payee's address as it appears in the PSP's records;
- details of transactions carried out; and
- details of any refunds.

For each payment transaction or refund, at least the date and time of execution of the payment, the amount and currency of the payment and the MS of origin of the funds must be recorded and provided. Certain information relating to refunds should also be recorded.

This information must be kept by PSPs for three calendar years and will have to be reported to the tax authorities of their home EU MS (i.e. where they requested and obtained their payment license, which should correspond to the MS in which their registered office or head office is located) or their host EU MS, meaning any MS other than the home in which PSPs provide payment services via an agent, a branch or directly.

As illustrated in the below table, the periodicity of the reporting will be quarterly and the deadline for the submission of the data will be the last day of the month following the relevant quarter:

Period (starting January 2024)	Deadline
1 January - 31 March	30 April
1 April - 30 June	31 July
1 July - 30 September	31 October
1 October - 31 December	31 January

EU MS must ensure that information is shared with other EU MS through the new centralized EU-wide electronic system, called the Central Electronic Payment Information System (CESOP), no later than 10 days after the above deadlines. Subsequently, Eurofisc officials can view the payment information sent by other MS through CESOP.

It is worth mentioning that the EU MS are required to implement this Directive into domestic law by 31st December 2023. Until today, only Denmark, Estonia, France, Slovakia and the Netherlands have done so. In the other MS, either there is no draft legislation yet or the proposed draft legislation has not yet been transposed into domestic law (e.g. Luxembourg).

Considering that PSPs might bear reporting obligations in different MS, they should carefully monitor the details of the implementation of these new rules across the EU (notably in relation to the penalties that could be triggered in case of non-compliance).

Conclusions

The guidelines issued by the EU Commission and the subsequent VAT committee guidelines on the issues arising from digital payments show once more that any assessment must be performed with care.

The complexity in determining the correct VAT treatment for these transactions is not limited to whether a service linked to payment could qualify for the VAT exemption applicable to payments and transfers. In case of composite supplies, particular attention should also be paid on whether there is a single service or separate supplies for VAT purposes. In certain cases, taxable services in essence may benefit from a VAT exemption if they should be viewed as a key component to better enjoy a VAT exempt service. On the contrary, services that could in principle benefit from a VAT exemption will be subject to VAT if they should be viewed as ancillary to the principal taxable services.

Besides the VAT implications linked to the treatment of commissions itself and the financial risks linked to it, the VAT treatment of income received by PSPs has an impact on their right to recover input VAT, with potential adjustments to be made on input VAT deducted on assets. We therefore urge businesses engaged in payment services to perform a review of their business model and global VAT situation.

Finally, in light of their new recordkeeping and reporting obligations, PSPs should assess in a timely manner the VAT implications on their operations and whether their IT systems are sufficiently robust to capture the required data.

How BDO could help you?

Should you need any assistance with applying the correct VAT treatment to your business model and reviewing the potential impact on your input VAT recovery as well as with the assessment of the VAT implications of the new recordkeeping and reporting obligations, please feel free to contact our **VAT advisors**.

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