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IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

on a common system of financial transaction tax and amending Directive 2008/7/EC

{COM(2011) 594 final}

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ANNEX 1

RESULTS OF THE PUBLIC CONSULTATION

1. PUBLIC CONSULTATION

The public consultation¹ was launched on 22 February 2011 and was closed on 19 April 2011. It was launched in order to receive stakeholder feedback on the initiative and in particular:

- (a) to test the assumptions and collect related evidence as regards the definition of the problems;
- (b) to assess the impact of the set of policy options; and
- (c) to consult on more detailed aspects of the feasibility and design of the policy options.

2. SUBMISSIONS BY STAKEHOLDER GROUP

The public consultation generated considerable interest. More than 200 individual replies and a very large number of petitions were received. All individual responses to the public consultation are made public². The feedback was divided into 6 stakeholder groups and subgroups listed below with the corresponding number of inputs³:

| Registered financial organisations | |
|--|-----------|
| Banking | 16 |
| Financial markets/securities | 10 |
| Fund/asset management | 5 |
| Insurance | 9 |
| Financial sector in general | 2 |
| Mutuals | 2 |
| Real estate (with links to the financial sector, e.g. REITs) | 1 |
| Total | 45 |

| Registered non-financial organisations | |
|---|----|
| NGO | 14 |
| Trade unions | 17 |
| Industry/real sector/SMEs | 8 |
| Accounting/tax consultancy | 5 |

¹ http://ec.europa.eu/taxation_customs/common/consultations/tax/2011_02_financial_sector_taxation_en.htm

² http://circa.europa.eu/Public/irc/taxud/consultation_taxation/library

³ A large number of contributions were not filed in the correct dedicated email or directly to the general consultation email and had to be assigned to the respective stakeholder group at the processing stage under certain assumptions.

| | |
|---|-----------|
| Real estate (general, i.e. not only those with links to the financial sector) | 1 |
| Total | 45 |

| | |
|--|-----------|
| Non-registered financial organisations | |
| Banking | 12 |
| Financial markets/securities | 3 |
| Fund/asset management | 5 |
| Insurance | 1 |
| Real estate (with links to the financial sector, e.g. REITs) | 1 |
| Total | 22 |

| | |
|---|-----------|
| Non-registered non-financial organisations | |
| NGO/ Research institute | 31 |
| Trade unions | 17 |
| Industry/real sector/SMEs | 5 |
| Accounting/tax consultancy | 3 |
| Real estate (general, i.e. not only those with links to the financial sector) | 2 |
| Parliamentary group/ Party | 5 |
| Total | 63 |

| | |
|--|-----------|
| Public authorities | |
| Central government/Ministry of Finance | 4 |
| Central banks | 3 |
| Regional authority | 10 |
| Total | 17 |

| | |
|------------------------|-------------------------|
| Citizens | |
| Individual submissions | 21 |
| Petitions | 3411⁴ |

| | |
|--|-------------|
| Total individual submissions | 213 |
| Total submissions (including petitions) | 3624 |

3. DETAILED POSITIONS OF STAKEHOLDERS

3.1. Registered and non-registered financial organisations

Taxation not an appropriate tool

⁴ There are claims that many more such e-mails have been sent.

Besides the general opposition to any and all types of additional tax burden on the financial sector or financial markets, financial organisations argue that taxation is not an appropriate and sufficiently targeted tool to tackle behavioural issues (e.g. excessive risk taking) and that the cumulative impact of newly introduced or to be introduced regulatory measures would be detrimental to the financial sector and the economy as a whole. In particular, additional taxation would be contrary to the recapitalisation of banks and other financial institutions.

An additional argument is that if regulatory measures are geared towards the optimum level (e.g. desirable and acceptable leverage and/or risk), then tax measures would distort the policy impact towards a sub-optimal outcome.

Over-taxation

All replies essentially reject the argument for under-taxation of the financial sector. They argue that the VAT being an indirect tax is ultimately borne by consumers. Therefore, financial sector's individual clients, and not the financial sector itself, are the ones that benefit from the VAT exemption. The financial sector bears the tax burden from the non-deductibility of input VAT. With regard to the VAT exemption, some of the replies advocated for a solution involving the abolition of the exemption.

Additional taxes in certain Member States (e.g. insurance premium taxes and other parafiscal charges, bank levies, payroll and turnover taxes, limited deductibility of certain interest expenses or bad debt provisions) were highlighted in that respect by some respondents. Others argue that fair value taxation would tax (unrealised) gains in the upward section of an economic cycle, while the offsetting (carry back/forward) of the corresponding losses in the downward section of an economic cycle would generally be limited.

Some respondents opined that there must be an overall capping of all contributions through taxation and regulation in order to protect the capital base.

EU competitiveness and risk of relocation

The respondents advance arguments related to risks for the competitiveness of the EU financial sector and the risks of relocation (outside the EU and to unregulated non-transparent markets). Other risks identified include a tendency to take up higher risks to compensate for the additional tax burden. Referring to the origins of the financial crisis, it is also argued that in case of relocation of "risky" activities the "importing" of non-EU risk would still remain or become even stronger.

General tax principles

From their perspective, any new taxation would be contrary to fundamental tax principles as equal treatment, proportionality and ability to pay. Banks and other financial organisations being simply conduits would not be able to bear the tax burden of any new tax themselves. The tax burden would essentially be shifted to any of their stakeholders, i.e. shareholders, customers or employees.

EU right to act

Four national bank associations and three insurance representatives questioned the EU's right to act on this fiscal issue, based on the principle of subsidiarity. They highlight that the financial sector in their particular Member State had not benefitted at all from any public support and was not involved in the financial crisis like financial sectors from other Member States.

Scope of the measures

Specific industries within the financial sector like insurance, financial markets/securities, fund/asset managers and real estate investments reject common measures targeted towards the financial sector defined broadly. It was pointed out that the financial crisis did not originate in those sectors, they had fundamentally different business models and they have unduly suffered from it, while at the same time providing stability to the financial systems in Member States. Any such cross-subsidisation was considered highly distortive.

Banks on the other side advocate for measures encompassing the financial sector defined broadly. They argue that not all banks were in the origin of the crisis, did not engage in unduly risky activities, did not receive public support. Furthermore, those that have received such support have largely already repaid it to the Member States' budgets.

Importance of the financial sector

Some of the respondents stressed the key role of the financial sector for the development and the proper functioning of Member States' economies.

An argument advanced against the FTT stated that speculation facilitates the functioning of financial markets, provides liquidity, reduces volatility and improves price discovery and that even a very low-rate FTT would hurt those functions. Several respondents advocated for an exemption for liquidity providers, market makers/specialists, systemic internalisers and central counterparties. The similar argument that high frequency trading is not a risky activity was also voiced.

FTT or FAT

While the majority of respondents in that group would oppose both options, there were a few that would rather favour a rent-taxing or risk-taxing version of the FAT based on the corporate income tax base principles in each Member State compared to a FTT.

Double taxation

Almost all respondents, especially from the banking sector, posed issues of double taxation created by new unilaterally adopted measures by several Member States.

Other technical questions

A great part of respondents refused to reply to the technical questions, arguing that no opinion could be presented unless there is stronger justification for implementing any of the outlined options for taxing the financial sector or there is greater clarity with regard to the actual features of the measures being considered. In addition, replies to many technical questions varied widely across the respondents from this group. Nevertheless, the following can be highlighted as common points among the answers to the technical questions:

- Using the underlying as the FTT base for derivatives is disproportionate, because it does not reflect the value or the risk associated with the derivative.

- Hedging activities are perceived as unduly burdened by a FTT. Several contributions advocated for an exemption for hedging activities.
- Expected administrative costs are generally considered high for any of the options and their respective designs. Some respondents agreed that an exchange-based FTT would have comparatively low administrative costs, but argued that this would have an adverse effect on investment in transparent markets. Other respondents would rather favour a CIT-based rent/risk taxing FAT from administrative costs point of view.
- On the issue of alignment with VAT most respondents replied that such alignment would not be practical and that the VAT exemption must be addressed through amendments to the EU VAT rules.

3.2. Registered and non-registered non-financial organisations

The positions of the two major groups within that category differed diametrically.

a. Industry/real sector/SMEs, Accounting/tax consultancy, Real estate (general, i.e. not only those with links to the financial sector)

While the replies were largely not in favour of additional taxation on the financial sector, essentially employing the same issues and arguments brought forward by the financial sector respondents⁵, the positions expressed were comparatively more moderate and detailed with regard to the technical part of the questionnaire.

SME and other industry representatives voiced against financial sector taxation fearing an increase to the cost of capital, investment, jobs, a decrease in the lending capacities of banks and a transfer of the tax burden to (corporate) clients.

Several industry representatives argued explicitly against an FTT (at EU or global level).

b. NGOs and trade unions

A substantial number of submissions were received from charitable organisations and other NGOs as well as trade unions.

FTT or FAT

NGOs and trade unions (registered and non-registered) are strongly in favour of a broad-based FTT levied at EU level (some submissions would accept also Eurozone level). NGOs are largely neutral towards a FAT as long as it does not "crowd out" the FTT implementation. Some trade unions, especially those from the financial sector⁶ are clearly against an FAT, essentially considering it as a tax on labour.

⁵ E.g. EU right to act, tax principles, cumulative burden together with regulation, etc.
Financial sector trade unions have been processed as part of non-financial organisations due to the fact that their submissions were sent to the non-financial sector dedicated mailbox.

Taxation an appropriate tool

All respondents of that subcategory accept taxation as a relevant policy tool. Various arguments were advanced, including contentions that the financial sector: does not benefit the real economy,

- gambles with the real economy performance and global GDP,
- performs socially useless activities,
- is generally under-taxed,
- enjoys an explicit public guarantee (privatisation of profits and socialisation of losses),
- benefitted substantial public support and
- poses systemic risk.

Another argument brought forward in favour of financial sector taxation relates to the broader discussion on approaches to addressing fiscal consolidation challenges. Other fiscal consolidation measures (e.g. reduction of public spending, increase of general direct and indirect taxation levels) are more socially costly as an alternative to the financial sector taxation and in particular the FTT.

Impact on employment and SMEs

The great majority of replies contended that an FTT would have a positive impact on employment and SMEs because it will have a stabilising effect on the markets and will drive capital out from speculation into the real sector. Others accepted a possible decrease in the employment levels in the financial sector, but claimed that this was a desirable effect.

Under-taxation

All replies from this respondent subgroup opined that the financial sector is under-taxed, mainly because of the VAT exemption of most financial services. Other arguments were the profound use of offshore structures and other techniques for tax planning and excessive leverage, driving effective tax rates down. The most cited subsectors were investment banking and alternative investment funds.

Scope of the measures

Some professional trade unions voiced against any tax burden being disproportionately put on traditional banking activities.

Tax incidence and cumulative effect

While admitting that the FTT will most probably be passed on to clients, most of the replies argued that the actual tax incidence will fall primarily on speculators and will not affect

regular investors. Any cumulative effect was desirable in order to curb speculative high-speed trading, while the notion of a cumulative tax is not in contradiction with any general tax principles, because there is no real value added at any stage of the trading of a financial instrument.

Other technical questions

Almost all respondents from that subgroup limited their comments to technical issues related solely to FTT. The common points in the answers to the technical questions of that subgroup are as follows:

- the taxable persons must be the contracting parties;
- the place of taxation must be the place of settlement (place of trading);
- the tax revenues must be transferred from the collecting agent at the place of settlement/trading to the Member States of the contracting parties;
- hedging by industrial companies is long-term business, is always related to a relevant underlying and will therefore not be strongly affected;
- central bank operations may be exempt;
- there may be a de-minimis rule operating through a refund mechanism;
- administrative costs were considered low.

3.3. Authorities

A comparatively much smaller number of replies were received by public authorities, especially by central authorities.

a. Central banks

All three Central banks that replied to the public consultation are clearly against either a FTT or FAT. One of the banks questioned the compatibility of a currency transaction tax with the EU Treaty freedoms. It was regarded as a barrier to intra-EU trade between Eurozone and non-Eurozone Member States. They also voiced against any tax that would reduce market liquidity and jeopardise the recapitalisation efforts of banks and the financial sector in general.

Different country experiences and the different level of development of financial markets across Member States were also pointed out as an argument against a common EU action.

b. Central governments/Ministries of Finance

One Ministry of Finance objected to any EU action contending that fiscal policy is within the ambit of Member States' competences and that the different impact of the crisis and situation of Member States' financial markets does not support an EU-wide approach. It also strongly opposed the extension of other Member States' taxing powers beyond their fiscal borders and

taxing separately capitalised legal entities in other Member States (spill-over effect). Another Member State also presented a similar argument that financial markets of Member States were affected differently by the crisis and the fiscal support took different forms. Both Member States claim that the financial sector in their jurisdictions is not under-taxed.

The two other Member States would accept financial sector taxation, including FTT, but at global level. While noting the technical difficulties related to a FTT, one of those Member States would also accept an EU-wide FTT. Nevertheless, that Member State would prefer a FTT in the form of a currency transaction tax due to lower relocation risk and easier technical implementation. It also has reservations with regard to FAT and especially rent/risk taxing FAT.

c. Local authorities

Local authorities (mostly representatives in the Committee of Regions) accept a broad based FTT at EU level. The argumentation and the actual replies repeat the arguments voiced by NGOs and trade unions.

d. Citizens

Citizens' individual submissions and the very large number of petitions are generally in favour of a broad-based FTT.

4. FOCUSED CONSULTATION WORKSHOP

On 4 May 2011 a focused consultation workshop with representatives of relevant associations of financial market operators⁷ took place at DG TAXUD's premises.

The agenda of the workshops included a preliminary summary by TAXUD of the results of the public consultation, a round-table on industry's assessment of expected administrative costs related to FTT and FAT and a number of technical issues, including those covered by the public consultation questionnaire.

4.1. Taxud's preliminary summary of the results from the public consultation

TAXUD gave a presentation on the Impact Assessment on financial sector taxation and progress made so far (current debate, assessment criteria, FTT, FAT and balance sheet taxes, preliminary results for the public consultation, technical questions).

⁷ European Association of Cooperative Banks, European Savings Bank Group, European Banking Federation, European Association of Public Banks, Association of International Life Offices, Comité Européen des Assurances, Association of European Cooperative and Mutual Insurers, Association Internationale des Sociétés d'Assurance Mutuelle, European Fund and Asset Management Association, Alternative Investment Management Association, The European Forum of Securities Association, European Central Securities Depositories Association, International Capital Market Association, Federation of European Securities Exchanges,

- **EFSA (securities)** said a clear justification for under-taxation should be provided by the Commission and whether the introduction of new taxes at EU level is justified. They stressed that some Member States already took measures to compensate for the cost of crisis.

TAXUD noted that 10 Member States already introduced bank levies.

EFSA also pointed out that their members would not be in favour of a bank levy at the EU level (Member States already have country-specific levies in place, additional tax may cause distortion effects).

- **EFAMA (funds)** asked what was the rationale to use new corrective measures and that a cumulative effect (taxation at EU level vs. Member State level) should be considered. It should also be defined what will the tax revenues be used for and whether they will go to the EU budget. They also pointed out that it may be hard to get agreement on taxation at EU level as unanimity is required for both adoption and amendment, therefore the tax instruments are not as flexible and practical as regulation.
- **EBF (banks)** said that a clear justification for the under-taxation should be provided. They wondered whether the Impact Assessment would be sufficiently holistic and whether all policies (Lisbon strategy, FSAP, capital adequacy rules, accounting issues, etc.) are taken into account, i.e. cumulative effect on the financial sector. They stressed that the burden on financial sector is already very high. They also mentioned "Giovanni Group" which produced two reports where they listed the barriers in the internal market and taxes on financial transactions was one of them.
- **EACB (banks)** pointed out that the Commission should analyse the proportionality of measures (costs/benefits of the implementation). TAXUD explained that proportionality is at the core of any Impact Assessment. TAXUD said that the assessments of costs would be welcome from meeting participants.
- **EAPB (banks)** also pointed out that FTT could be a new barrier in the internal market. They also said that the Commission should use precise wording (e.g. "fair and substantial"), it is also unclear what is behind "additional burden" and pointed out that in some Member States constitutional problems may arise related to introduction of new taxes.

4.2. Industry's assessment of expected administrative costs related to FTT, FAT and balance sheet taxes (bank levies)

TAXUD explained in the introduction that some associations were already part of EU Savings Directive exercise in assessing expected administrative costs, so they already know it is very difficult to quantify costs. However, it is a strict obligation for any Impact Assessment to provide this quantification. TAXUD said that some cost estimates of Member States when introducing new taxes are available and pointed out that the Commission does not have sufficient time at disposal for an in-depth cost analysis.

- **EFAMA (funds)** said that there are opposing views which of potential new taxes, FTT or FAT, would be more costly. There are no clear estimates as the design of the new tax is

not known, however, the interest of market participants is to proceed in a least painful and cheapest way possible.

- **EBF (banks)** pointed out that in "Giovanni report" (financial transaction type taxes is mentioned as a barrier) there is a reference to the administrative costs of central clearing and said that a narrow-base tax would be costly, even more for a broad-base tax as it would be hard to identify who is the collector of the tax. They also said that for FAT the cash-flow based approach is incompatible with the financial statements approach (accrual base) and pointed out that a specific system would be needed. They concluded that it is impossible for the EBF to provide a cost estimate as there are too many options proposed with no defined design.

4.3. Technical issues

4.3.1. Industry scope

TAXUD explained that FAT would need a definition of the industry scope. Bank levies, for example, apply to banks only (HU- implementation is broader as regards the industry scope, whereas in the UK there are explicit carve-out clauses for some activities). Financial sector taxation would need to cover a broader industry, not only banks (IMF also advocate for a broader industry scope). Commission's definition is also broad.

- **BIPAR (insurance)** said that the insurance sector is perceived as being undertaxed as it is VAT exempt like banks, however, there are other taxes like the insurance premium tax. They mentioned the VAT directive Council revision which is ongoing.
- **EUSIPA (derivatives)** stressed that it should not be said that the financial sector is under-taxed due to VAT exemption as that is an indirect taxation and pointed out that the final consumer is under-taxed. They also said that FAT (addition method) is a sort of VAT (interaction with Art. 401 of VAT Directive), there is also an employment tax for banks or "la taxe boursière" for the operations on the stock exchanges. They also questioned whether the existing VAT system is in favour of banks.
- **EBF (banks)** pointed out that the VAT system is very complex, in 2007 there was a proposal for VAT treatment of financial services, so they proposed that the solution should be found within VAT as adding new taxes may further increase the complexity. EBF also said that the creation of disparities in the financial sector should be avoided and that FTT and FAT may not be able to identify what is excessive risk taking, at the end one cannot prevent the banks from taking risks
- **EFSA (securities)** said that if the justification for new taxes is under-taxation of certain activities (level playing field for all market participants) one should look at "shadow banking".

TAXUD explained that risk has not been properly assessed and has been isolated in special purpose vehicles. It may prove to be challenging to tax those entities. EFSA said that risk is inherent and if there is a problem the taxpayer should not be required to sort it out. Banks take credit risks on a daily basis, it is their business, management measures are important in reducing risks.

- **CEA (insurance)** said that not all market participants can be treated in the same way as different actors have different risk, so there is a danger that one sector will end up paying for other sectors (cross subsidisation).
- **EAPB (banks)** provided an example of Germany which introduced bank levy, however the so called "promotional banks" (state-owned banks with state guarantees) were exempt from bank levy as they work in the public interest.
- **EACB (banks)** pointed out that limiting the scope only to financial sector is too narrow; also other entities should be included.
- **EFAMA (funds)** pointed out that there is limited scope for "excessive" risk taking as regulatory measures were already put in place in order to reduce the risk.

4.3.2. Availability of relevant accounting data

TAXUD explained that financial statements may differ across industry (even for the bank levy). IFRS consolidated financial statements are widely used (with the exception from US GAAP).

- **EFSA (securities)** stressed it is important to know which type of accounts would be taxed, individual or consolidated: taxing rights are broad, so there may be an issue of double taxation.

They also explained that in the UK the basic idea for bank levy is to use consolidated accounts. For those who do not have consolidated accounts, they would need to put together a new balance sheet which may entail additional administrative costs.

- **EBF (banks)** asked how would those who have no consolidated accounts be taxed. They also said that in some Member States it is prohibited to use the IFRS at an individual level.

EBF committed to check with banks and provide estimates how many banks would face problems due to the fact that they do not have consolidated statements.

- **EACB (banks)** said it was a question of scope as it may happen that those who do not provide consolidated accounts will not be taxed. They said that cooperative banks only provide annual accounts at national level, only listed banks have consolidated accounts.

4.3.3. Under/over taxation

CEA (insurance) pointed out that insurance premium tax is a national based tax, but present all over Europe (15%-20% on average), it is burdensome for the sector (Germany more than EUR 10 billion/year).

- **EBF (banks)** stressed a more holistic approach is needed as banks have to comply with many regulative requirements already.

- **EFAMA (funds)** wanted to know what is the rationale for the initiative, is it meant to be short or long-term measure. It may take many years to see what is the effect of new regulatory measures.

They also wanted to know if the Commission knows how much tax revenues would be raised with new taxes introduction.

TAXUD explained that the main purpose of the Impact Assessment is the overview of all possible new measures.

- **EUSIPA (derivatives)** pointed out it should be made clear how this new revenue would be spent.

4.3.4. Interaction with VAT and CIT/PIT

TAXUD explained that FAT additional method is essentially linked to VAT.

- **EUSIPA (derivatives)** explained the "Poddar system" (1999) which has not been accepted as Member States were not certain of the results for tax revenues of such taxation.

They explained that "Poddar system" is in fact income tax on a rough basis which was stopped as Member States were against as it was considered impractical.

TAXUD explained that that FAT additional method is not necessarily linked to VAT through VAT credits, (i.e. clients would not receive a "FAT invoice") and therefore the uncertainty about the tax revenues may be minimised.

- **EFSA (securities)** inquired what would be the justification for expanding the scope of VAT (i.e. FAT additional method) and questioned the consequences.
- **EBF (banks)** stressed that some Member States are using "option to tax", it is also a way how to apply VAT to all or some financial services by Member States. Proposal for a new directive for VAT reform services in 2007 (option to tax for the financial institution, not for Member States). If the debate evolves this may lead to economic double taxation as tax basis will be the same.

4.3.5. Double taxation

TAXUD explained problems with double taxation in case of FTT, FAT and bank levies.

- **EUSIPA (derivatives)** said there are already indirect taxes in the financial sector, so if FTT or FAT are added there will be a double taxation and pointed out that such taxation should be integrated into the VAT systems. They referred to the ECJ case law ("Chicago case").

TAXUD asked about source based vs. residence based VAT. EUSIPA could not comment.

They said that with regard to tax base for derivatives (futures, swaps), only the "result" (difference between open and end price) should be the tax base, more like an income tax as the futures can be perceived as betting. They consider that imposing tax on notional value of derivatives would harm the derivatives market and questioned how structured products would be taxed.

- **EBF (banks)** said that there is a contradiction when it comes to taxing derivatives. The objective is to reduce excessive risk taking by taxing notional value of derivatives; however a swap is a tool for risk reduction.

4.3.6. Relocation and competitiveness

EUSIPA (derivatives) said that when the resident of the state participates in a transaction, the place of taxation should refer to residence. Tax should be levied by bank, intermediaries, i.e. paying agents who collect taxes. On the other hand, one cannot control or forbid OTC transactions.

- **EFSA (securities)** expressed concern about new EU taxes as they would reduce the competitiveness of the EU. Relocation is easy and EU could lose its competitive position against non-EU based financial institutions (e.g. relocation to Switzerland, Singapore).

EFSA said that in case of foreign exchange trading there is a revenue estimate that 75% of FTT revenue would come from London. They wanted to know what would be the margins in case of FTT and wondered whether a rate of 0.01% might "kill" the market.

- **EBF (banks)** said that in case of broad base FTT there should be a link to central depositary system.

TAXUD explained there is a resident principle of the trading party (the person is taxed on global basis), source principle (every transaction within the state is taxed) and "UK stamp duty" principle where the transfer of securities which are registered in the country is taxed (legal certainty).

- **EACB (banks)** wanted to know if there is a differentiation between real currency transactions vs. speculative transactions and pointed out that in case of currencies it will be hard to administer the tax.

TAXUD explained no differentiation can be done, all currency transactions would have to be taxed.

4.3.7. Credit supply (cost of credit)

EUSIPA (derivatives) said that whenever a new system is introduced, there will be administrative costs. They mentioned the example of Germany when introducing the withholding tax where the costs were very high.

EACB said that they can provide some figures on administrative costs of WHT implementation in Germany. They will send the information to TAXUD within a week.

They also said that one can use a bank deposit to circumvent FTT as there is a small difference between such a deposit and bonds.

- **EBF (banks)** said that any new tax burden born by financial institutions will be transferred to shareholders and customers and it does not depend on a tax base.
- **EFAMA (funds)** pointed out the impact on cost of saving and pensions.

4.3.8. Interaction with regulation (cumulative impact)

EBF (banks) said that there would be double taxation resulting from existing national taxes at Member States level and potential new taxes at EU level.

- **EUSIPA (derivatives)** suggested to change the EU Directive on capital duty as there are Member States that are not in favour of such taxation, but this may prove difficult in practice (unanimity).

5. CONSULTATIONS WITH ACADEMIA AND PRACTITIONERS

The Brussels Tax Forum⁸ on "Taxation of the Financial Sector" was held on 28 and 29 March 2011. The audience and the presenters included a large number of academics, tax practitioners, policy-makers and other stakeholders.

The main topics discussed were as follows:

- responsibility of the financial sector for the crisis;
- the public support for the financial sector;
- under/over taxation of the financial sector;
- interaction with initiatives in the area of financial regulation;
- options for taxing the financial sector – FTT and FAT.

Tax Forum, Day 1

Opening Speeches

The opening session set the political scene for the debate on financial sector taxation (FST). The priorities in the Commission agenda and the recent initiatives, illustrated by Commissioner Semeta in his opening speech, were generally received with favour by the European Parliament, as Ms S. Bowles (Chairwoman EP's Committee on Economic and

⁸ http://ec.europa.eu/taxation_customs/taxation/gen_info/tax_conferences/tax_forum/index_en.htm

Monetary Affairs) pointed out in her intervention. With specific regard to FST, she mentioned the EP report on Innovative Financing which proposes an FTT potentially able to generate € 200 billion per year in the EU. Such tax would have a low rate (0.01% - 0.05%) to minimize relocation risk and a broad base. The need for action in the field of FST was also stressed by Mr. A. Balog (Hungarian Deputy State Secretary for Taxation Affairs) in the framework of a more general reconsideration of the design of the tax systems after the crisis. Finally, Mr. Ph. Etienne (French Presidency of the G20) highlighted the need for a coordinated approach on FST initiatives. In particular, while an FTT at the global level would be preferable, adoption only within the EU can also be considered if no consensus would be reached in the G20.

Session: Why taxing the financial sector?

Mr. P. Delacroix (PwC and Solvay Business School) illustrated the preliminary findings of a study commissioned by DG TAXUD on the national fiscal rules applicable to the financial sector in the EU27 and 4 major economies (Switzerland, USA, China and Singapore).

The legal treatment of banks in the CIT field does not significantly differ from that of non-financial corporations. In addition, there is no indication of actual practices differing from legal provisions and allowing of special tax treatment for banks. A few rules derogating from the general CIT principles concern provisions on loans/doubtful debtors, thin cap rules, interest deduction for banking branches, withholding tax exemptions, the accounting treatment of financial instruments (mark-to-market/mark-to-model).

In the domain of indirect taxation, the well known difficulties in measuring the value added for margin-based activities have led to a generalized exemption of financial services from VAT. The 'option to tax' (art. 137(1) (a) of Directive 2006/112/EC) is implemented in 7 MS. Nearly all MS have introduced other taxes on financial services, not all specifically compensating for the VAT exemption. For instance, in France and Denmark there is a compensating payroll tax on salaries apportioned on the basis of pro rata taking into account turnover that is VAT-exempt. Similarly, 19 MS have an insurance premium tax or similar tax. Other taxes such as stamp duties, stock exchange taxes, bank levies, special contribution taxes, government levies, registration taxes, mortgage taxes are also levied. There is no differentiated fiscal treatment of labour income in 24 countries. Amongst the 7 countries that have reported a different tax treatment, France and UK have already abandoned their measures. Moreover, while Greece, Italy and Portugal have applied tax surcharges on bonuses, Ireland will tax future bonuses – as a response to the crisis.

Finally, forms of securities transaction taxes already exist in 8 EU MS (France, UK, Belgium, Poland, Greece, Romania, Ireland, Finland), with different characteristics: various tax rates (generally from 0.15% to 1.6%); with or without ceiling/maximum amount of tax due; with a broad tax base (all financial instruments, including derivatives) or not (e.g. only equities, or only listed stocks, or only local securities); with potential exemptions, e.g. for non-resident taxpayers, or institutional investors acting for their own account.

In the second intervention of this session, Prof. H. Huizinga (Tilburg University) addressed the issue of potential under-taxation of the financial sector. When it comes to the CIT, there is no evidence that shareholder returns enjoy lower tax levels than other sectors. Of course, this might also be indicative of the benefits of any potential under-taxation being passed on to bank customers and suppliers.

Implications of VAT exemption cause financial services to households to be under-taxed, while services to businesses to be overtaxed. Overall, exemption can lead to overtaxed or under-taxed financial services, depending upon the share of business demand in financial services and the magnitude of irrecoverable VAT. Drawing on his own research, the author quantified the potential increase in overall VAT revenue from eliminating the existing exemption around €12.2 billion euros for EU15 in 1998. This could be translated into €18 billion for EU27, or 0.15 % of EU27 GDP.

In stressing the need for considering tax incentives in addition to the mere level of taxation, prof. Huizinga also clarified that schemes like deposit insurance, liquidity provision by the ECB and bailout of ailing financial institutions can be considered as implicit fiscal instruments. In particular, the transfer from the liquidity provision from the ECB (assuming a 5% spread with the rate obtainable on the market) amounts to roughly 1.0 percent of euro zone GDP, over entire crisis. If crisis occurs every 30 years, the yearly cost amounts to 0.03 % of GDP. In addition to that, the direct fiscal cost of the 2007-2009 crisis amount to 1.7 % of EU27 GDP (0.06 % a year under the assumption above). Leaving aside the (substantial) output losses generated by the crisis, adding up the figures above would give a total under-taxation of the financial sector in the range of 0.24% of EU27 GDP per year. In the IMF calculations, additional revenues of this magnitude can be generated by a broad Financial Activities Tax with rate of 5 %. Importantly, less additional revenue is needed if new regulation and taxation can reduce bank risk taking.

Among the points raised in the panel discussion, particularly relevant are the observations made on the ability of financial institutions to avoid current tax provisions, e.g. through tax planning. In particular, gathering evidence on effective tax rates for banks seems of primary importance.

Tax Forum, Day 2

Morning session: The financial transaction tax

The morning session of day 2 of the Brussels Tax Forum dealt with the Financial Transactions Tax and was chaired by Karel Lannoo (CEO of Centre for European Policy Studies), who set the scene by making references to existing taxes of this type – namely in the UK and Switzerland.

The first part of the session included a presentation by Prof. Stephan Schulmeister (Austrian Institute of Economic Research). He outlined briefly the planned tax base, which would be the value of any traded financial asset, while the possible tax rates are 0.1%, 0.05% and 0.01%. Necessarily higher leveraged financial assets would be affected to a great extent. The policy reasoning behind this is minimisation of short-term speculation (60-70% of trade is through high-frequency trading) and stabilisation of the markets, which would, according to Prof. Schulmeister, also have a long-term effect on preventing the formation of pronounced bull/bear markets, because the long-term bull/bear market is an extension of the short-term trends. He claimed that the same mechanisms were into play with regard to the CDS and sovereign debt crisis.

In Prof. Schulmeister's revenue calculations of 1.8% of EU GDP a scenario of 70% reduction in derivatives trading is taken into consideration. The collection would be done at the point of settlement, while all OTC transactions would be taxed at the level of the Central Counterparty Platforms (CCPs). All countries in the same or similar time zone would need to participate. Revenues would be shared among the trading place, the trading partners' states and the EU. If a decentralised approach is adopted, a charge of 2% would need to be applied on all transfers of funds abroad.

Prof. Schulmeister went on to address criticism on his ideas arguing that price discovery has turned into price distortion. He argues that other versions of financial sector taxes such as the FAT and bank levies treat equally the "harmful" and traditional "boring" banking. In addition, the FAT or bank levies cannot address the speculative practices by other businesses.

The second presentation was done by Prof. Seán Yoder (University of Maine). He gave a brief overview of transaction taxes in general and their practical implementation, especially in Latin America. They are seen as a way of taxation of an activity (and not of income or expenditure) and to correct negative externalities. He criticised the cascading effect of those taxes and their negative effect on liquidity (whose effects would be felt far beyond the financial sector) and also hinted towards the possibilities of circumvention by way of netting settlement agreements.

Prof. Yoder went on to question the revenue shortfalls and significant relocation risks, and because of the globalisation of the financial markets cannot fulfil its Pigouvian role. As a substantial and stable revenue raiser, he dismissed the financial transactions tax as underperforming. For a currency transaction tax, Prof. Yoder gave an example of cross-trading that is done between less-common currencies. If Euro transactions were subject to an FTT, cross trading would shift to USD positions.

The presentations were then followed by a panel discussion, which included Roger Kaiser, Senior Adviser, Tax & Financial Reporting at the European Banking Federation, Max Lawson, Head of Development Finance and Public Services at OXFAM, Jeffrey Owens, Director of the Centre for Tax Policy and Administration at OECD, Victoria Perry, Division Chief of the Revenue Administration Division at the Fiscal Affairs Department at the IMF, Stephan Schulmeister, Economist at the Austrian Institute of Economic Research and Seán Yoder, Professor at University of Maine.

Jeffrey Owens presented some of the arguments for levying a tax on the financial sector, e.g. the need of fiscal consolidation, the need to pay for the financial crisis, to "put sand in the wheels" of the spurring markets, to discourage risk-taking and compensate for the opportunities for aggressive tax planning exploited by the financial sector actors. New regulation and tax must send coherent signals (but not to undermine banks' recapitalisation) and there is need for coordination in that respect.

Victoria Perry also made a short description of the difference between the FAT and the FTT. FTT was seen as more distortionary due to its cascading nature and could increase volatility. On the FAT, she argued that economic rents may exist in the financial sector from the "too big to fail" assumption, but also from the perceived "complexity" of products and schemes. Excessive leverage and not excessive trading was seen to describe more appropriately the genesis of the financial crisis. That view was also shared by Jeffrey Owens.

Roger Keiser argues that the imposition of taxes conflicts with the banks' recapitalisation. Any tax burden would be more easily passed onto clients thereby increasing the cost of credit. A narrow-based FTT would be easily administered, but would pose problems of relocation to less institutionalised and less secure markets. A broad-based FTT would on the other side have problems with enforcing, collection and compliance. On FAT, he argues that it must be compatible with existing accounting information and not require a specific set of accounts. A cash-based FAT was seen as less proportionate compared to a standard VAT on the financial sector. Duplication of EU and national bank levies would need to be avoided.

Max Lawson pleaded for a "Robin Hood tax" to aid developing countries, which was threatened by the fiscal consolidation efforts of developed countries. He raised support for any tax on the financial sector, with preference towards an FTT.

The ensuing debate focused on whether economic rents were generated by excessive risk taking of economic efficiencies, the effect of FTT on market volatility (and the definition thereof), the causal link between financial instruments' leverage and the volumes traded, the challenges of distinguishing "gambling" from sound financial activities and the effectiveness of taxation as compared to regulation.

Afternoon session: The Financial Activities Tax

The closing session of the Brussels Tax Forum dealt with the Financial Activities Tax and was shared by Professor Marcel Gérard (University of Louvain-La-Neuve). Professor Clemens Fuest (Oxford University) set the scene by explaining the basic concept of a FAT and highlighted that there is in fact no single FAT proposal but that it is rather a family of taxes which differ significantly in their design. Professor Fuest elaborated on the three types where the addition-method FAT is essentially an instrument to correct at least partly the VAT exemption of many financial services. For this reason the tax is based on the sum of wages and profits which is a rough proxy for value added-of the financial sector. The rent-taxing FAT is more directed to potential economic rents while the risk-taxing FAT is more directed towards a regulatory goal, namely the reduction of risk-taking in the financial sector. He pointed to potential administrative problems and high compliance especially with regard to the latter two versions of FAT.

Professor Fuest concluded that before thinking about a FAT as an additional tax instrument it would be helpful to first fix issues in current tax systems. Specifically, he pointed to first getting the newly introduced bank levies right, notably the issues of double taxation, fixing the issue of VAT exemption for financial services within the current VAT if possible, reforming general corporate income taxation (debt bias and other issues), reforming financial sector of regulation, in particular capital requirements and after that to start reconsider FAT.

Professor Peter Birch Sorensen (Danmarks Nationalbank) presented the Danish experience with a variant of the FAT which is designed to correct at least partly the VAT exemption of the financial sector. The Danish tax is levied on the payroll of sectors which are VAT exempt. With respect to the financial sector, the tax applies to banking, insurance, mortgage credit and pension funds with a rate of currently 10.5%. Professor Sorensen elaborated on the concept and also gave some indications on whom the burden of such a tax might fall. When comparing wages and employment in the financial sector as well as interest spreads in

Denmark, the Danish tax did not seem to have negative effects on those. Rather the indicative data suggests that the burden was borne to a large extent by capital owners of banks.

Professor Sorensen pointed to the fact that the Danish tax misses an important element compared to the FAT currently debated internationally. It does not include profits in the tax base. He suggests that this could be considered since this would make the tax a better tool to tax value. Professor Sorensen concluded from the Danish experience shows that an origin-based FAT can be implemented as (an imperfect) substitute for the missing VAT on financial services and that with a moderate tax rate, there is no reason to fear that a FAT will seriously discourage financial sector activity. He also noted that an internationally coordinated FAT would increase the revenue potential and that there are no convincing technical arguments for excluding (pure) profits and stock options etc. from the FAT base.