

# The Financial Transactions Tax

## Where are we now?

Global FS Tax Newsflash

November 2011

This Newsflash provides an update on the ongoing debate regarding the introduction of a financial transactions tax (FTT) within the EU following the release of the draft EC Directive on 28 September 2011. We review the principal developments which have taken place since the release of the draft Directive, assess the current position of the various Member States towards the proposals and comment on some of the practical implications of the FTT if introduced. Finally, we will look at how this issue might develop in the future.

### Principal developments

**Release of the draft Directive:** The draft Directive was published on 28 September and proposed an EU wide FTT which would apply to a wide range of transactions in financial instruments (including equities, bonds, derivatives and foreign currency) undertaken by EU based “financial institutions” which would include banks, insurance companies, leasing companies, mutual funds and pension funds. The rate of FTT would be fixed by each Member State subject to a minimum rate of 0.1% for financial transactions and 0.01% for derivatives<sup>1</sup>.

**Comments by individual Member States:** A number of senior politicians from individual Member States have commented on the proposed FTT since the release of the draft Directive. Arguably the most vocal of these have been Wolfgang Schäuble, the German Finance Minister, a strong advocate of the FTT and George Osborne, the UK Chancellor of the Exchequer, who is opposed to the FTT unless it is adopted at a global level. There is also a divergence of views amongst other EU Member States – see below.

**G20 Cannes Summit:** The FTT was one of the items on the agenda of the G20 Summit held in Cannes, France on 3-4 November. The meeting considered a report<sup>2</sup> presented by Bill Gates regarding innovative ways in which

development aid may be financed in the future which referenced a FTT as one potential option. However, the G20 meeting stopped short of endorsing the FTT only going so far as to “acknowledge the initiatives in some of our countries to tax the financial sector for various purposes, including a financial transactions tax, inter-alia to support development.” Other G20 members such as Canada and India took the opportunity to reaffirm their opposition to a FTT.

**ECOFIN meeting:** The FTT was also discussed amongst European finance ministers at the ECOFIN meeting in Brussels on 8 November although no consensus view was reached on its introduction. However, the EU Commissioner for Taxation Mr. Algirdas Šemeta reaffirmed the EU Commission’s intention to press ahead with the FTT at an EU level notwithstanding the lack of global agreement stating “Some may ask whether the Commission feels the need to reconsider its proposal on the basis of last week’s G20 Summit. The answer is categorically: No”.

In addition to these official discussions the FTT proposals continue to receive widespread coverage and in many cases support from other bodies including charities and other Non Government Organisations (“NGOs”), the wider public and even the church.

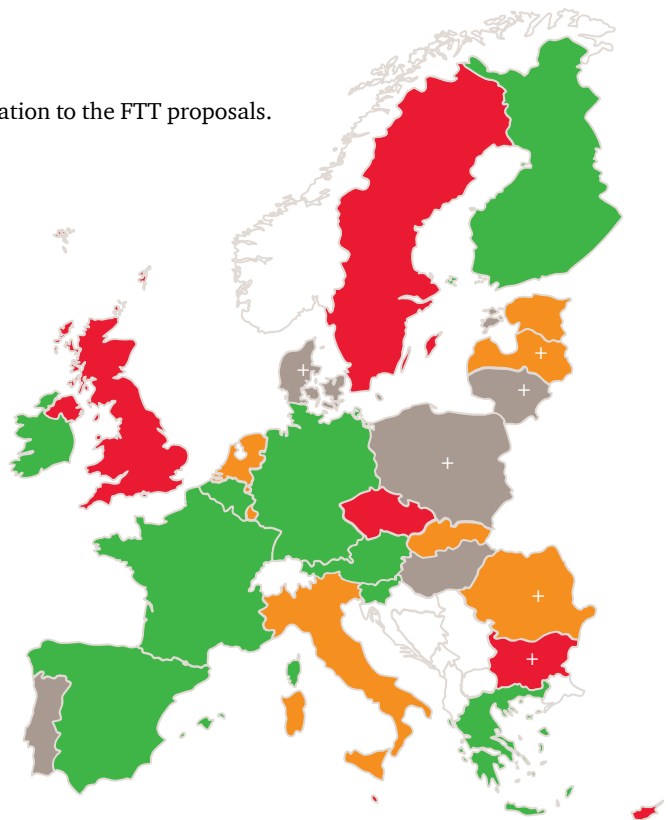
<sup>1</sup> A more detailed summary of the proposed FTT regime is contained in our Global FS Tax Newsflash entitled “The EU Financial Transactions Tax Draft Directive and the Implications for the Global FS industry” dated 29 September.

<sup>2</sup> See ‘Innovation With Impact: Financing 21st Century Development’ A report by Bill Gates to G20 leaders, Cannes Summit, November 2011

## The Views of the EU Member States

There are diverse views amongst the 27 EU Member States in relation to the FTT proposals. These are summarised in the table and illustrations below.

9 countries	In favour of an EU wide FTT Austria, Belgium, Finland, France, Germany, Greece, Ireland*, Slovenia, Spain
6 countries	Opposed to an EU wide FTT Bulgaria, Czech Republic, Cyprus, Malta, Sweden, UK
7 countries	Not formally opposed, but expressed concerns about its impacts Estonia, Italy, Latvia, Luxembourg, Netherlands**, Romania, Slovakia
5 countries	No formal opinion expressed to date Denmark, Poland, Portugal, Hungary, Lithuania
	Eurozone countries
+	Euro+ Pack Member States



Given the highly charged political atmosphere surrounding the FTT proposals, in our view there is a very real risk that some fundamental tax policy concerns raised by the proposals will not receive a fair hearing and could have an adverse economic impact on both the financial services industry and the wider economy within the EU. These include:

- Is the financial services industry undertaxed? One of the justifications put forward by the EU Commission in support of a FTT is that the financial services sector “is currently undertaxed by comparison with other sectors” by virtue of the VAT exemption on financial services. However, a recent study<sup>3</sup> undertaken by prof. B. Lockwood (University of Warwick, UK) and PwC questions whether this is indeed the case.
- Absence of look-through approach and cascading impact of a FTT: By virtue of the way in which the proposed FTT is currently structured, single transactions may result in multiple FTT charges with the result that the overall level of tax cost associated with the transactions may be well in excess of the 0.1% and 0.01% headline rates. In the case of a transaction between 2 EU-established Financial Institutions, the FTT would be levied twice on both the seller’s and buyer’s side. In addition, transactions undertaken via intermediaries (e.g. brokers/dealers) could be subject to multiple FTT charges, unless the intermediary financial institutions act in the name or for the account of another financial institution or is exempt (e.g. central counterparties).
- Impact on savers and pensioners: The definition of “financial institution” contained within the draft Directive includes investment firms, collective investment schemes, pension funds and their managers. As holders of some of the largest pools of investable financial assets, it is clear that these institutions would bear a significant proportion of the cost of a FTT. With regard to th

## **Where to from here?**

Given the political nature of the debate surrounding a FTT and the wider political uncertainty within the EU generally at present it is difficult to predict at this stage where the proposals may ultimately land. Our comments on some of the potential outcomes are discussed below:

- **Global adoption of a FTT:** Some countries have said that the FTT is only viable if there is global adoption. Even though most major countries have budget deficits (including some not seriously affected by the global financial crash - for example Australia) and an FTT might be a tempting way of raising revenues there is as yet no suggestion of support by countries outside the EU
- **EU wide adoption of a FTT:** Adoption of a FTT at an EU wide level would require unanimous agreement amongst all 27 Member States. Given the vocal opposition of certain territories – in particular the United Kingdom and Sweden – EU wide adoption also seems unlikely. During their last meeting held on 18 November 2011, the German Chancellor Angela Merkel and the UK Prime Minister David Cameron made no progress with regard to the plans for a European FTT.
- **Euro-zone / subset of EU countries adoption of a FTT:** It is possible that a FTT might be adopted amongst Euro-zone members (plus other EU Member States who are also in favour) perhaps as part of the wider move to closer fiscal union within the Euro-zone. FTT would then have to go forward under enhanced cooperation “as a last resort”. This procedure requires Qualifying Majority Vote of all 27 EU Member States to allow a subset of at least 9 EU Member States to go ahead with the (same) FTT proposal. Only the participating Member States are bound by it and decide by unanimity. However, importantly, under this scenario, financial institutions based in Europe but outside the “FTT area”, may still be impacted by the “extra-territorial” reach of the FTT when doing business with parties based in the FTT area. It is hard to predict whether and when a vote on enhanced cooperation will be called as a last resort. Given Germany and France’s strong support for a FTT this would not be beyond the realms of probability given both countries’ leading role in seeking to resolve the Euro-zone crisis.
- **Withdrawal of FTT proposals and focus on alternative tax measures:** Given the significant question marks which have been raised in relation to the suitability of a FTT from a policy perspective and the wide divisions amongst EU Member States in relation to the tax, the EU Commission may conclude that it would instead be preferable to refocus the debate around alternative taxes which could be applied to the financial services sector to ensure it makes a fair and substantial contribution. In particular this may see the focus shift back to the possibility of a financial activities tax (“FAT”) which was discussed at length in the IMF report issued in March 2010.

## **Next steps**

- The draft Directive has been sent to the 27 national Parliaments for the subsidiarity principle test (i.e. whether they believe the EU Commission has over-stepped its competence and that the proposal should not be introduced at EU-level). A one-third minority of national Parliaments could thus delay the law-making process for a few months and force the EU Commission to “review” its proposal (so-called “yellow-card system”). The 8-week deadline will elapse on 30 November 2011.
- On 5 December 2011, technical expert discussions will start on the FTT proposals in the EU Council Working Party on Tax Questions. If this EU Council Working Group can reach agreement on the technical and planning aspects, the proposal is moved up to COREPER, i.e. the EU Council’s political voting assembly composed of the EU-27 permanent representatives. If political agreement cannot be reached here, the proposal moves up to ECOFIN.
- The debate on FTT must be seen in the context of the current highly charged political debate in Europe on strengthening of economic convergence within the EU/ Euro-zone, improving fiscal discipline and deepening economic union, including even the possibility of limited EU Treaty changes. EU leaders will meet again on 9 December 2011 to discuss these matters. The Euro Plus Pact Member States (23 of the EU-27) will discuss progress on national implementation of the Pact’s commitments, including a report of their Finance Ministers on progress made on coordination of tax policy issues. There’s an urgent need for clarity among all parties on FTT, and in the current Euro crisis, it cannot be ruled out entirely that certain EU leaders will try to speed up the introduction of FTT in a subset of EU Member States.
- Denmark will take over the rotating 6-monthly EU Presidency from Poland on 1 January 2012. FTT is earmarked as a top priority initiative. The Danish presidency will therefore be instrumental in taking FTT further. An important date may be the final ECOFIN meeting under the Danish presidency on 19 June 2012.

## **Actions required**

Given the importance of the FTT proposals for the EU financial services industry, it is very important that the industry seeks to actively engage with all relevant stakeholders in the public debate to ensure that the wider implications of the FTT proposals are clearly understood.

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