

# 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

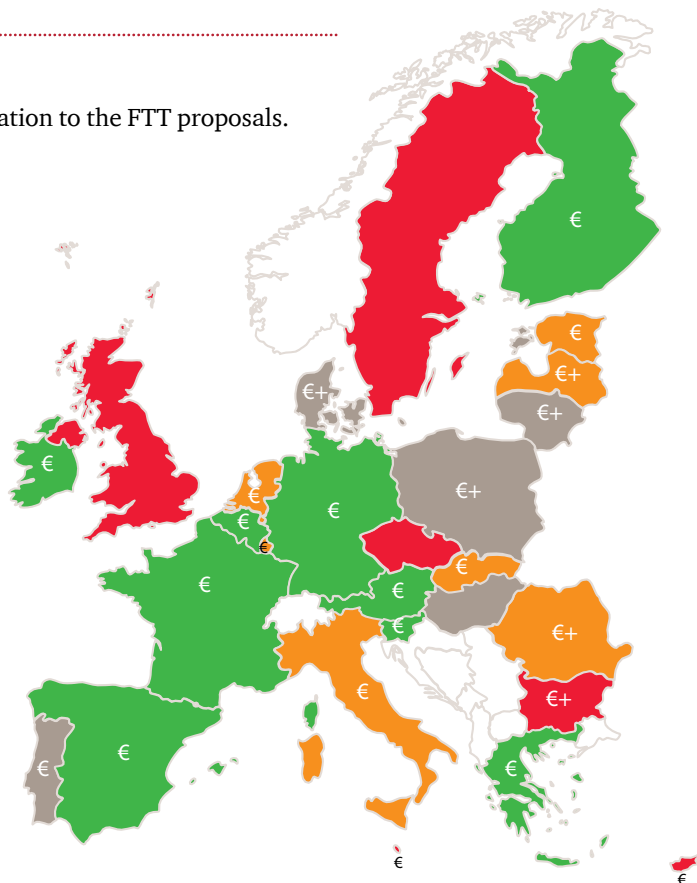
There are diverse views amongst the 27 EU Member States in relation to the FTT proposals. These are summarised in the table and illustrations below.

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

\* Ireland is in favour of EU wide FTT, but not supporter of an Euro-zone FTT.

\*\* It seems that the Netherlands recently voiced concerns with the current proposal, while the Dutch Prime Minister stated last month he supports the proposal, unless it is introduced in only a few countries.

The current status about the EU FTT is based on the best information available to date. The positions expressed by some Member States have evolved over the last months and may still be subject to change depending of the political debate. Therefore, this information must be carefully considered.



## Practical Implications of a FTT – who really pays?

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 the mutual fund industry specifically, the issue and the redemption of shares and units of UCITs and Alternative Investment Funds may also be subject to the FTT in addition to the financial transactions undertaken by the funds themselves. This would in turn lead to a reduction in the returns payable to individual savers and pensioners. Consequently, although the EU Commission states that a

FTT is not intended to apply to consumers it is clear that the cost of the tax will be borne by consumers through lower returns on their savings and pensions.

- Costs to the real economy: Non-financial services companies utilise a wide range of financial products in order to conduct their businesses. For example, derivative products are commonly used by manufacturers to hedge exposures to foreign exchange movements in respect of exports whilst other industries such as airlines may use derivatives to hedge against rises in fuel prices. To the extent that financial institutions are subject to a FTT in respect of these types of transaction this is likely to lead to an increase in the price of such products to the end-user which ultimately will lead to an increased cost to the final consumer of the relevant product.
- Impact on risk management activities: Many financial and non-financial institutions utilise financial products to manage risk (i.e. through hedging). To the extent that the price of such products increases as a result of the imposition of a FTT there is a risk that companies may choose not to hedge their exposures which would result in an increase in the level of risk.
- Relocation of financial services business: On the top of the increasing regulatory burden being imposed on the financial services industry within the EU, the introduction of a FTT at EU (or narrower) level may further increase the risk of relocation of financial services activities out of the EU. Whilst the EU Commission may consider that this is a desirable (and indeed intended) result in respect of certain activities – such as high frequency trading – it is likely that other types of financial services business may also migrate which would have a damaging effect on the wider EU financial services industry. The inability of a FTT to discriminate between what is considered “good” versus “bad” types of financial transaction is one of its more significant flaws.
- Compliance burden: the imposition and collection of a FTT would impose a very significant additional compliance burden on those financial institutions covered by the tax.

<sup>3</sup> See report entitled “How the EU VAT exemptions impact the banking sector” published on 20 October 2011.

## **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 overstepped 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.

## **Contacts**

If you would like further advice or information in relation to the issues outlined above, please call your local PwC contact or any of the individuals listed below:

### **David Newton**

*Global FS Tax and  
Insurance Leader*

+44 (0)20 7804 2039  
david.newton@uk.pwc.com

### **Joseph Foy**

*PwC US*

+1 (646) 471 8628  
joseph.foy@us.pwc.com

### **Bob Van der Made**

*EU public affairs Brussels*

+31 (0) 887923696  
bob.van.der.made@nl.pwc.com

### **Richard Collier**

*Global Banking and  
Capital Markets Leader*

+44 (0) 20 721 23395  
richard.collier@uk.pwc.com

### **Hans-Ulrich Lauermann**

*PwC Germany*

+49 69 9585-6174  
hansulrich.lauermann@de.pwc.com

### **Frans Oomen**

*PwC Netherlands*

+31 (0) 887925156  
frans.oomen@nl.pwc.com

### **William Taggart**

*Global Asset  
Management Leader*

+1 646 471 2780  
william.taggart@us.pwc.com

### **Matthew Barling**

*PwC UK*

+44 (0) 207 2125544  
matthew.barling@uk.pwc.com

### **Peter Yu**

*PwC China/ HK*

+852 2289 3122  
peter.sh.yu@hk.pwc.com

## **Singapore Financial Services Tax Partners**

### **Paul Lau**

+65 6236 3733  
paul.st.lau@sg.pwc.com

### **Tan Tay Lek**

+65 6236 3768  
tay.lek.tan@sg.pwc.com

### **Anuj Kagalwala**

+65 6236 3822  
anuj.kagalwala@sg.pwc.com

### **Teo Wee Hwee**

+65 6236 7618  
wee.hwee.teo@sg.pwc.com

### **David Sandison**

+65 6236 3675  
david.sandison@sg.pwc.com

### **Yip Yoke Har**

+65 6236 3938  
yoke.har.yip@sg.pwc.com

[www.pwc.com](http://www.pwc.com)

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