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Financial Transaction Tax through Enhanced Cooperation: Questions and Answers

(see also IP/13/115)

Why has the Commission proposed a Financial Transaction Tax for implementation through enhanced cooperation?

The Commission initially proposed a Financial Transaction Tax to be implemented by all 27 Member States, in September 2011 (IP/11/1085). However, following intense discussions in Council, it was found that unanimity would not be reached on this proposal in the foreseeable future.

Nonetheless, a number of Member States expressed a strong willingness to go ahead with the FTT. Therefore, in autumn 2012, 11 Member States wrote to Commissioner Šemeta, officially requesting enhanced cooperation on the financial transaction tax to be authorised, on the basis of the Commission's 2011 proposal.

The Commission carefully assessed these requests against the criteria for enhanced cooperation in the Treaties. On the basis of that assessment, in October 2012, the Commission proposed a Decision to allow enhanced cooperation on the FTT (see IP/12/1138). This was backed by the European Parliament in December and agreed by European Finance Ministers at the ECOFIN in January 2013.

Once the green light for enhanced cooperation had been given, the Commission could proceed with the detailed proposal on the FTT to be applied by the 11 Member States. This is what has been presented today.

What is enhanced cooperation?

Enhanced cooperation is when a group of at least 9 Member States decide to move ahead with an initiative proposed by the Commission, once it proves impossible to reach unanimous agreement on it within a reasonable period. It is only relevant to policy areas which require unanimity, and it aims to overcome the situation whereby certain Member States are prevented from advancing with a common approach due to the reluctance and non-agreement of others.

Clear provisions and conditions for enhanced cooperation are set out in Article 20 of the TEU and Articles 326 to 334 (TFEU).

For more information on the enhanced cooperation procedure, see MEMO/12/799.

Which Member States intend to implement the common FTT through enhanced cooperation?

Eleven Member States, representing 2/3 of EU GDP, have been authorised to establish the common financial transaction tax under enhanced cooperation. These are: Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia.

Can others join the FTT group later, and how?

Yes. One of the conditions of enhanced cooperation under the Treaties is that it should be open to any other Member State joining at a later stage if it wishes to do so. In order to join, the Member State would need to submit a request to the Commission, which would then assess this against the criteria set out in the Treaty (as it did the initial requests).

What are the key features of the FTT proposed today for the 11 Member States?

In line with the requests of the 11 Member States, today's proposal very much reflects the Commission's original FTT proposal in terms of scope and objectives.

When it comes to **objectives**, they remain exactly the same. These are:

- To tackle fragmentation of the Single Market that an uncoordinated patchwork of national financial transaction taxes would create;

- To ensure that the financial sector makes a fair and substantial contribution to public finances and covering the cost of the crisis, particularly as it is currently under-taxed compared to other sectors;

- To create appropriate disincentives for financial transactions which do not contribute to the efficiency of financial markets or to the real economy

With regard to the **scope of the FTT**, it again mirrors the 2011 proposal, in that:

- The base of the tax is very wide, covering transactions carried out by financial institutions on all financial instruments and markets, once there is an established economic link to the FTT-zone

- The rates are low, at 0.1% for shares and bonds, units of collective investment funds, money market instruments, repurchase agreements and securities lending agreements, and 0.01% for derivative products. These are proposed minimum rates, and participating Member States would be free to apply higher rates if they wanted to. The tax would have to be paid by each financial institution involved in the transaction;

- Day-to-day financial activities of ordinary citizens and businesses (e.g. insurance contracts, mortgage and business lending, credit card transactions, payment services, deposits, spot currency transactions etc.) are excluded from the FTT, in order to protect the real economy;

- The raising of capital (i.e. primary issuance of shares and bonds, units of collective investment funds) and certain restructuring operations will not be taxed. Also, excluded from the scope of the FTT are financial transactions with the ECB and national central banks, the EFSF and ESM;

- The "residence principle" remains a core element to safeguard against the relocation of financial transactions. Under the residence principle, who is party to the transaction is what counts, not where it takes place. If a financial institution involved in the transaction is established in the FTT zone, or is acting on behalf of a party established in this zone, then the transaction will be taxed, regardless of where it takes place in the world;

To further prevent avoidance of the tax, the Commission has added to this proposal the "issuance principle". This means that a transaction will also be taxed, whenever and wherever it takes place, if it involves financial instruments issued in one of the participating Member States.

What are the main changes compared to the 2011 FTT proposal, and why have they been introduced?

Any changes in today's proposal compared to the one in 2011 serve one of two purposes: either to provide more legal clarity, where it was seen to be necessary, or to reinforce anti-abuse and anti-avoidance provisions, as the 11 participating Member States had requested. The main changes are:

- Issuance principle has been added as an anti-avoidance measure (see below for more details). A general and a specific anti-abuse clause have also been added to the proposal;

- Member States and other public bodies, when managing public debt, are now explicitly excluded from the scope of the Directive;

- ECB, EFSF and ESM are now explicitly referred to as being exempt from FTT

- Exchanges of financial instruments will now be considered as two transactions for tax purposes, while repurchase and reverse repurchase agreements and securities lending and borrowing will be regarded as only one transaction, as they are economically equivalent to a (single) credit operation;

- The issuance of shares and units in collective investment funds and restructuring operations are now also excluded from the scope.

Are there still benefits to the FTT if it is not applied by all Member States?

Absolutely. The Commission would have liked to see the FTT applied throughout the entire EU. However, as this proved impossible, enhanced cooperation is the right way to proceed. The objectives set by the Commission are still valid and achievable. A common FTT will ensure a fairer contribution to public finances from the financial sector, which is currently under-taxed by about €18 billion a year in the EU, and which has tremendously benefited from rescue operations pre-financed by tax payers. And it will reduce the fragmentation of the Single Market, by having a single system for taxing financial transactions which covers 11 Member States. Importantly, those that participate in enhanced cooperation on the FTT will also have a significant new source of revenue without placing further burden on the ordinary citizen.

How much revenue is the FTT expected to generate? How will this be used?

The proposed FTT applied under enhanced cooperation is expected to generate €30-35 billion a year, corresponding to 1% of the participating Member States' tax revenues.

The Commission has proposed that a portion of the revenue could be used as an own resource for the EU budget, resulting in a corresponding reduction of the national GNI contributions of participating Member States. The money for the national budgets could be used to help consolidate public finances, invest in growth-promoting activity, or meet development aid commitments. Ultimately, it will be for participating Member States to decide how the revenues of the FTT should be used.

Is there a risk that the financial sectors in participating Member States will relocate to Member States or non-EU countries not applying this common FTT?

Robust measures remain in today's proposal to mitigate the risk of relocation. In particular, the "residence principle" ensures that if any party to the transaction is established in the FTT-zone, the transaction is taxed, regardless of where in the world it takes place. This means that financial operators would only be able to avoid the FTT if they were prepared to relocate, abandon all their clients in the 11 Member States, and refrain from any interaction with financial institutions established in the participating Member States. This makes relocation a very unlikely response, particularly considering the low rate of the proposed FTT and the fact that the participating Member States comprise 2/3 of EU GDP.

Nonetheless, the Commission took measures in today's proposal to further reinforce the safeguards against relocation. Under the issuance principle, financial products issued in the 11 Member States will be taxed when traded, even if those trading them are not established within the FTT-zone. Again, this removes any incentive to relocate in order to avoid the tax.

Thus, financial institutions would only be able to avoid paying the tax if they gave up their client base in the FTT jurisdiction with respect to financial instruments, and if they were to no longer trade in financial products issued there.

Does the proposed FTT respect the relevant territoriality rules?

Yes. The proposed FTT for the 11 Member States is fully in line with international law and EU taxation principles. Taxing cross-border services is a well-established principle in taxation. VAT can be used as a comparative example of how this works. When a Belgian citizen buys software on the internet from an American company, the software is taxed at the Belgian rate.

Moreover, many national financial sector taxes are based on the issuance principle and therefore apply to transactions which take place outside their own territory, once the financial product traded has been issued on their territory. The same ideas apply to the FTT proposed. As long as there is an established link between the transaction and the territory of a participating Member State, it is legal to charge this tax. Nonetheless, the proposal includes a general rule allowing the person liable to pay the FTT to prove that the link between the transaction and that territory ("economic substance clause") is insufficient, and that they therefore do not have to pay the tax.

What will be the impact of the FTT on growth and jobs?

The most up-to-date analyses presented by the Commission showed that the FTT will not lead to any job losses. In terms of economic impact, it is estimated to have a -0.28% impact on GDP in the long run. Smart recycling back into the economy of the revenues delivered by the FTT can even potentially lead to a positive impact on GDP of 0.2%. Both these figures are cumulative effects over periods of several decades based on economic models. Rather than the figures themselves what is important is that putting in place an FTT will not negatively impact growth or jobs.

Will the FTT hit the ordinary citizen?

The proposed FTT excludes the day-to-day financial activities of ordinary citizens and businesses, in order to protect them and the real economy. In fact, it is very well targeted to the financial sector. The proposal covers only transactions where financial institutions are involved, and around 85% of the transactions take place purely between financial institutions.

In addition, the minimum tax rates proposed are very low, to avoid significant knock-on effects on the real economy due to an increased cost of capital. Of course, just as they do with any costs they have, the financial institutions would have to assess whether they absorb such a tax or pass it on, taking into account market conditions / competition. But even if the financial sector does pass on some of the costs to its clients, the outcome would not be disproportionate. Any citizen buying, for example, €10 000 in shares would only pay a €10 tax on the transaction.

Will the FTT hit the non-financial sector and what about traditional investment banking?

The proposed FTT excludes the day-to-day financial activities of enterprises outside the financial sector. Thus, when SMEs or bigger companies need money and borrow it from banks or they issue new shares or enterprise bonds, no tax will be due. Also, when there is a merger and acquisition activity, or a management buyout in which financial institutions take a leading facilitator role, no tax will be due.

Only in case financial institutions were able to pass the cost of the tax on to their enterprise clients, some minor increases in the cost of could materialise. However, these should remain rather limited as most effects will have to be swallowed by the financial sector itself as 85% of all transactions take place amongst financial institutions with no outside client in sight.

Will the FTT be applied to pension funds, and could this have a negative effect on pensions and pensioners?

Pension funds do fall under the scope of the FTT. They are important actors on financial markets, and they are in direct competition with other investment funds, such as index funds shadowing stock exchanges or bonds markets. But the impact can be extremely limited, depending on both the asset allocation (portfolio) and on the investment strategy (more frequent trading vs. less frequent trading, for example). Pension funds generally have a diversified portfolio of assets and invest their money in financial instruments (mainly bonds) but also in assets which are not affected by the FTT, such as cash/currencies, deposits, real estate, loans, gold and silver etc.

Conservative fully-funded pension funds typically follow low-risk investment strategies that are mainly reflected in buying bonds or shares when they are issued and holding them until maturity. Such transactions are not covered by the scope of this tax.

For pension funds where there is a high degree of assets trading, the tax incidence will be higher. But an effect of the FTT could be to deter high turnover in pension funds, and encourage a move towards more long-term handling of funds. This, in turn, could substantially reduce the management fees of those funds in which pension funds often invest.

What will be the impact of the FTT under enhanced cooperation on non-participating Member States?

Before the Commission proposed that the 11 Member States should be allowed to move ahead with FTT through enhanced cooperation, it carried out careful assessment that the criteria set out in the Treaties were met.

Among these criteria was the stipulation that there should be no negative effects arising from enhanced cooperation on the obligations, rights and competences of the non-participating Member States, nor any competitive or other distortions for the Single Market. The Commission's analysis had positive conclusions on all these aspects.

Moreover, non-participating Member States will benefit from the improvements to the Single Market that a harmonised FTT amongst 11 Member States will bring in terms of simplification and reduced administrative burdens for businesses.

What will be the impact of the FTT under enhanced cooperation on the Single Market?

The FTT applied by 11 Member States would be positive for the Single Market. A common FTT system, shared by 11 Member States, would reduce the number of divergent national approaches to financial sector taxation. In doing so, it would lead to less competitive distortions, fewer tax avoidance opportunities, more transparency and information exchange amongst those taking part, and less compliance costs for businesses and operators across the EU.

When is it foreseen that the FTT would be implemented by the 11 Member States?

Today's proposal foresees the FTT for the 11 Member States entering into effect on 1 January 2014. Obviously, it depends on the Council reaching agreement on the proposal in time to respect this proposed implementation date. The European Parliament and the European Economic and Social Committee and National Parliaments will also be consulted, and national transposition would then be needed.