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The European Tax on Financial Transactions: From principle to implementation

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Abstract :

Believed to be "technically possible, financially vital and morally unavoidable" by the former President of the Republic in November 2011, the project for a European tax on financial transactions came to fruition during the Economy-Finance Council on 22nd January 2013 with the launch of an enhanced cooperation agreement. The choice of this format highlights the lack of unanimity over the project drafted by the Commission, without however challenging the principle of this levy. The means for the implementation of this new measure remain to be defined.

Tabled on 28th September 2011 the draft directive on a common taxation system on financial transactions [1] is believed by the European Commission to be one of the answers to the financial crisis of 2008. In its opinion the financial sector has a clear responsibility in the start of this crisis. This meant that the States had to intervene in support of their banking system at the risk of seeing their own budgetary difficulties grow and thereby witness an increase in the cost of re-financing their debt (Spain, Ireland). The aim is therefore to turn to the markets which are now stable again, and ask for their contribution. Some Member States also see in this measure a means to counter the speculative attitude of some financial players, who they notably deem responsible for their difficulties on the financial markets.

The dual goal set for the Commission's project has highlighted existing ambiguities about the very idea of the tax on financial transactions, a notion that is in fact quite vague, the source of enthusiasm on the part of those who support and denigrate capitalism, since its field of application is not defined. The amalgam made with the so-called Tobin tax is quite revealing. In 1972 American Nobel Prize winner James Tobin suggested a tax whose rate was to range from 0.05 and 1% on international monetary transactions alone to counter speculation affecting national currencies. This is a far cry from a levy on all financial activities and destined for development aid. James Tobin criticised this approach at the end of the 1990's. Hence to speak of a European Tobin tax might seem contradictory since the European Commission's project does not involve monetary transactions.

THE EUROPEAN COMMISSION'S PROJECT [2]

The project to tax financial transactions across Europe was addressed for the first time in 2009 by the Commission during G20 discussions on the introduction of a levy on financial movements worldwide. The financial transaction tax was then part of a certain number of working ideas in view of including banks in the States' efforts to halt the crisis. The Commission tabled its arguments in a communication published on 7th October 2010 before announcing on 29th June 2011 the future publication of a draft directive.

The proposal it presented on 28th September 2011 anticipates a wide ranging tax, since it would apply to all transactions between financial institutions (banks, *hedge funds*, Stock Exchanges, insurance companies, investment companies), if one of the financial institutions is established in the European Union (the so-called residence principle). Even if the transaction does not take place in the European Union, the aim is to counter the relocation of these movements. This option leads in fact to a globalisation of the tax since some financial players outside of the EU would be obliged to pay it.

Two types of market are affected by this measure – that of shares and bonds within which every transac-

1. Draft directive by the Council establishing a common taxation system on financial transactions thereby modifying the directive 2008/7/CE: http://ec.europa.eu/taxation_customs/resources/documents/taxation/other_taxes/financial_sector/com%282011%29594_fr.pdf

2. Information report n°4288 on the tax on financial transactions by MPs Jean-Yves Cousin and Pierre-Alain Muet, published by the European Affairs Committee at the National Assembly on 1st February 2012 analyses in detail the measure selected by the Commission: http://www.assemblee-nationale.fr/13/pdf/europe/rap-info/i4288.pdf.

tion will be taxed to a total of 0.1% and the derivatives market which is governed by the short term and within which profits are deemed low, will be subject to the tax to a total of 0.01%. But these products are deemed to be the most speculative. Most of the time however they are traded over the counter and will probably not be taxed. The world volume of over the counter transactions is estimated at 700,000 billion $. The Member States may decide to increase the share of revenues generated by taxing financial transactions at a higher rate.

The transactions undertaken on the primary market, those undertaken by the European institutions and the international organisations or those involving Member States' central banks, are exonerated. The anticipated proceeds of this product from this tax are estimated at 57.1 billion € per year. Transactions involving shares and bonds would bring in 19.4 billion € (6.8 from shares and 12.6 from bonds), those involving derivatives, 37.7 billion €.

The issue of allocating the proceeds of this tax has not yet been completely decided upon by the Commission. According to the draft directive the resulting revenues would be shared between the Union and the Member States. A share would be used as an own-resource for the EU's budget and would replace national contributions in part. The Member States do not all agree on this. The idea that this levy might comprise an EU own-resource and possibly be a constituent element in the Union's future budget, has not met with unanimity. France and Austria notably pleaded in support of the idea that a share of the revenues produced by this tax be "paid into a fund for education" within the EU's budget. Germany is however against the idea of it being used in the European budget.

DIVERGENCE BETWEEN MEMBER STATES [3]

The debate organised at the "Economy and Finance" Council (EcoFin) on 22nd June 2012 did not lead to unanimity on the part of the Member States on the creation of the tax. Finance Ministers also noted on 10th July that it would be impossible to come to agreement in the "near future". Article 192 of the Treaty on European Union anticipates fiscal issues being the focus of a unanimous vote. The UK and Sweden, although their economic and taxation models differ greatly, showed the greatest reticence about the Commission's project.

The failure of the Swedish bid to introduce this type of tax in the mid 1980's explains in part Stockholm's scepticism. The country indeed introduced a tax like this onto its shares market in 1984, which then extended to the bonds market. The 0.5% tax was abolished in 1990 given the relocation of transactions towards the City likewise that of the companies involved. The fear of capital losses is also behind Poland's reticence on this issue.

The UK wants to defend the City which it believes under threat by the introduction of this tax. In the UK's opinion there is a danger of the relocation of transactions towards other financial markets – America and Asia, and even in Europe (Switzerland and the Channel Islands), where it would be difficult to implement a European tax. The defence of their financial market is also behind the reticence on the part of Luxembourg, and even Malta, with regard to the Commission's project.

London also believes that the Commission's project illustrates its ignorance of national measures in this area. In 2011 the UK adopted a tax on banks' assets which means that the latter have to contribute to the dangers they had caused to the economy. Banks have to pay this tax if their debt rises over 20 billion €. Its rate was set at 0.07%. It weighs on the financial establishments' liabilities after the deduction of the capital, retail deposits and funds gained after re-pledging the sovereign debt and insurance contract reserves. Sweden introduced a similar system via a 0.036% levy which contributes to a fund designed to counter future financial crises. The British measure completes the *stamp duty reserve tax*, introduced in 1986, which comprises a registration duty on British shares or those registered in the UK but which are issued by foreign companies. Its rate varies between 0.5% and 1.5%. It is paid by the purchaser. It brings in between 3.5 billion € yearly to the UK.

3. The report by Fabienne Keller, Senator of Bas-Rhin, "The financial transaction tax: easy to design difficult to implement" published by the Senate's European Affairs Committee on 21st December 2012 presents the Commission's arguments and those of the States opposed to the tax in a balanced manner. http://www.senat.fr/notice-rapport/2012/r12-259-notice.html

QUESTIONS

Beyond national arguments it seems appropriate to look into the somewhat incomplete nature of the project put forward by the Commission which underestimates two points: the impact of globalisation caused by the residence principle and the reality of the economic effects of the tax.

On the first point the residence principle should logically mean that third States will raise a tax on transactions undertaken by a financial institution from an EU Member State. The feasibility of this is in fact a problem since it supposes cooperation with the tax authorities of third States and notably with those of the main stock exchanges in Asia or closer to home, in the Channel Islands. In any event the tax will impinge on the fiscal sovereignty of third States.

In terms of the second point the declared rates, which are relatively weak, do not reflect the reality of the transactions, since the latter generally involve several intermediaries and therefore several successive purchases. Each of these would be affected by the European levy. Hence the rate of some operations might rise beyond 2% because of the complexity and the number of the actors and transactions involved. Moreover the tax targets both the seller and the purchaser. An increase in transactions costs like this would affect the saver directly, whether this involves a small shareholder or someone having signed for a life insurance or a retirement savings product.
We should note that the reticence of some Member States is more to do with this vagueness on the part of the Commission than with opposition to the principle of the levy itself. Cyprus, Finland, Ireland, Poland and Romania, who are not very willing to move forwards on this issue, already have a tax like this.

The position adopted by the European Parliament on 23rd May 2012 may have contributed to the confusion since it is hesitating between two options. MEPs retained the principle of an exemption of pension funds and at the same time extended its field of application by strengthening the extra-community part of the measure. The financial institutions external to the EU will indeed be obliged to pay this tax if they have negotiated securities issued within the European Union. The European Parliament also wanted to link the acquisition of legal properties duties, that are integrated into the purchase of the security, to the effective payment of the tax. This condition is also the focus of the British customs stamp.

France has already adopted a tax on financial transactions. It entered into force on August 1st 2012 and comprises a levy of 0.2% on shares purchases of 109 groups whose HQ is established in France and whose market capitalisation is over 1 billion €. The proceeds of the French tax, originally estimated at 1.6 billion € is appropriated to the State budget and 10% is allocated to development aid. The impact of this tax on the markets is significant: French securities which are not affected by the tax have been the only ones to have risen since it entered into force. The average value traded on taxed securities has decreased by 18% since the introduction of the levy whilst those on shares of groups which are not subject to the tax have rise by 16%. This contraction in volumes will also affect revenues which might be brought down to 300 million € annually.

At the same time analysts note a move over to Contracts for Difference (CFDs) [4]. These contracts copy the market behaviour of securities without there being any ownership transfer. They are included in the category of derivatives and are therefore more speculative.
This perverse effect has to be taken into account when launching further negotiations over the format of the tax as part of an enhanced cooperation agreement involving 11 Member States.

WHICH TYPE OF TAX AS PART OF THE ENHANCED COOPERATION AGREEMENT?

Since there is no unanimous agreement on the issue, 11 Member States (Germany, Austria, Belgium, Spain Estonia, France, Greece, Italy, Slovakia and Slovenia) issued a request for an enhanced cooperation agreement on 9th October 2012. As part of article 20 of the Treaty on European Union enhanced cooperation agreements must include at least 9 Member States

4. Created in the City at the beginning of the 1990's Contracts for Difference are financial derivatives which enable the acquisition of an underlying asset depending on stock market prices: share, index, raw material or currency. The purchase of these contracts does not involve the concomitant possession of the asset. Allowed in Europe CFDs are banned on the American market.

which can establish a common policy as part of the European Union's non-exclusive competences. On 23rd October 2012, the Commission suggested that the Council give its go-ahead for the enhanced cooperation agreement. This was approved by a qualified majority at the Council after the prior approval of the European Parliament. This decision was taken on 12th December 2012 after a conclusive vote: 533 votes in support, 91 against and 32 abstentions. On this occasion MEPs invited the 11 Member States in the enhanced cooperation agreement to adopt a decision stipulating that they would proceed according to the ordinary legislative procedure.

On 22nd January 2013 the Council authorised the establishment of the enhanced cooperation agreement. No vote was made since only 6 countries – Bulgaria, Luxembourg, Malta, the UK, Sweden and the Czech Republic finally indicated that they were formally against this project as they abstained from the vote on the enhanced cooperation agreement. Ireland and Latvia also expressed reserve about the tax, but they did not go as far as opposing the principle.
Within the enhanced cooperation agreement all of the Member States are involved in the negotiations concerning the content but only the members who are effectively participating have any voting rights. The Member States who are not members at present can join whenever they want.

We might wonder at the shape of the future tax, whether this implies its field of application, its rate or the allocation of the proceeds, since the reticence shown by some States is still topical and will continue to be expressed during the negotiations. The project put forward by the European Commission on 14th February 2013 is mainly based on the initial text[5]. The changes made only affect the tax base in a limited manner. Hence French primary dealers (SVTs) and delivered repos would no longer be affected by the tax. SVTs are credit institutions or stock exchange firms responsible for monitoring State borrowing. Delivered repos are contracts which enable an institutional investor or a company to trade their liquidities against financial securities for a specific period of time. The Commission insists on the fact that financial transactions relative to monetary policy, to refinancing and to the management of public debts are to be exempt of the measure. Hence the tax would not be applicable to European Central Bank operations or to the euro zone's rescue funds (European Financial Stability Facility and the European Stability Mechanism). It also introduced anti-abuse clauses which specifically exclude current transactions undertaken by private parties or SMEs from the field of application (savings, insurance contracts, loans and payments).

The only significant amendment involves the introduction of the "place of issue" principle of the financial product, which is the base of the British "*stamp duty reserve tax*". This principle would be obligatory as a "last resort" and completes the residence principle. In this the Commission sees a means to calm fears on the part of a certain number of States as far as relocation is concerned. In doing this it takes up the European Parliament's argument.

At the same time the European Commission has published an in-depth impact assessment of the new measure [6]. The aim is clearly to reassure the reticent Member States about this tax, without however stepping down over its rate, which is deemed counterproductive by some, who have already introduced taxes on financial establishments.

Limited to 11 States the financial transaction tax might, according to German experts, generate annual revenues of about 20 to 37 billion €. The Commission is anticipating a sum of between 30 and 35 billion €. The 11 pioneer States alone represent two thirds of the EU's GDP and 90% of that of the euro zone.

There remains the issue of allocating the proceeds, since Germany is still against the Commission's idea that was repeated on 14th February, to allocate a share of the proceeds to the community budget. The Commission believes that this participation would reduce the direct annual contribution made by the States to the European budget. The remainder of the revenues would be distributed between the Member States according to their GDP, unless they agree on another means of calculation. The European Parliament seems

5. ec.europa.eu/taxation_customs/resources/documents/taxation/com_2013_71_fr.pdf

6. ec.europa.eu/taxation_customs/resources/documents/taxation/swd_2013_28_en.pdf to support this option in that it sees a means to guaranteeing the European budget with a sustainable own-resource. The Irish Presidency of the Council believes that this issue will undoubtedly be the focus of negotiations. The Netherlands have also said that they would only integrate the enhanced cooperation agreement if the tax proceeds were used as a sustainable resource. A first revised assessment of the measure is due to occur at the "Economy-Finance" Council on 14th May 2013. The Commission hopes for a rapid compromise so that the directive can be transposed into national legislation by 30th September 2013. The tax would enter into force on 1st January 2014.

CONCLUSION

The project for the European Financial Transaction Tax is facing basic opposition that is linked in part to the economic model adopted by certain Member States like the UK or Luxembourg for example. It has not been accepted by other countries because of doubts about its base or its rate. With regard to one of the initial goals behind the Commission's proposal – associating the financial sector to the States' effort to counter the crisis but also regulating the sector better – we have to be careful about these two points during negotiations which are about to start in the Council. The French example tends indeed to highlight that this tax, announced as being neutral, does indeed affect the functioning of the markets and may cause financing issues for some businesses. The perverse effect of the measure may even lead to investors using certain, more speculative derivatives. A consensus also has to be found on the allocation of the proceeds. The European Financial Transaction Tax is however a symbol that we have to support. The enhanced cooperation agreement should lead to the implementation of a levy, less divisive politically and more effective economically, which would help to complete the community legal framework in the financial area.

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