EBF Ref.: D2329-2012

Brussels, 21 November 2012

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 4,500 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU.

EBF REFLECTIONS ON THE EUROPEAN FINANCIAL TRANSACTION TAX

Background

On 13 November 2012, the ECOFIN Council took stock of developments regarding the introduction of a Financial Transaction Tax (FTT) in a number of Member States wishing to participate in an Enhanced Cooperation Procedure (ECP) and referring to the scope and objectives of the proposal presented in 2011 by the European Commission (the Commission).

Council discussions had revealed in June and July 2012 that there was insufficient support for the Commission’s proposal for a Directive aimed at introducing an FTT throughout the EU 27 Member States. In September and October 2012, 11 Member States formally wrote to the Commission requesting permission to proceed through the ECP. On 23 October 2012 the Commission submitted a proposal for a Decision authorising ECP for an FTT.

There are very few precedents for the use of ECP, as it is intended to be used as a last resort where objectives cannot be achieved in the normal course of EU business. In the case of the other precedents, ECP has been the culmination of years of wrangling over a proposal. In the case of the FTT, the Commission Proposal has been a mere 14 months in discussion.

Key Points

The European Banking Federation (EBF) questions whether the key legal requirements for use of ECP are met in the circumstances and whether the Commission’s swift assessment of the appropriateness of, and authorisation for, ECP can be deemed sufficiently considered and robust.

The EBF is concerned that neither the Commission nor the participating Member States have acknowledged the critical appraisals of the FTT, as outlined in the International Monetary Fund’s

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report, ‘Financial Sector Taxation -The IMF's Report to the G-20 and Background Material’[1], or as captured in the analysis by the UK House of Lords[2], amongst others. Nevertheless, it is reassuring that participating Member States, if not the Commission, acknowledge the present ‘necessity for an assessment of impact that examines the possible economic consequences associated with the introduction of a Financial Transaction Tax by way of enhanced cooperation.’

Given that the scope and objectives of the ECP for an FTT would be based on the initial Commission Proposal, the European Banking Federation continues to believe that the Commission’s proposal, even on the basis of only 11 participating Member States, will be detrimental to the EU economy and, therefore, questions the desirability and sense of a tax which threatens economic growth and jobs.

A technical note is attached as an appendix, in which the irrationality of some technical aspects of the Commission’s proposal has been highlighted.

[1] http://www.imf.org/external/np/seminars/eng/2010/paris/pdf/090110.pdf
[2] http://www.publications.parliament.uk/pa/ld201012/ldselect/ldeucom/287/287.pdf

Technical note on the Commission FTT Proposal

The purpose of this appendix is to reiterate and highlight the irrationality of the technical approach used in the Commission's FTT proposal:

- If an activity is considered harmful, it should be forbidden through appropriate regulation. Financial transactions are just 'tools' and taxing them is like penalising all the users of these tools because of difficulties in identifying which of them are actually misusing the tools.

- Because of the fear that some actors are using untaxed products as a substitution, hardly any exemptions are provided by the Commission FTT Proposal.

  Typically, the Commission's proposal does not provide any exemption for the financial intermediaries whereas the 'cascading effect' of the FTT would have a disastrous impact on the banking system. The so-called 'cascading effect' results from the cumulative effect of the FTT: for example, a transaction with a client, triggers several hedging trades within the financial sector, all taxable in accordance with the Commission's proposal. Suggesting that such a set-up should be replaced by 'pure intermediation' reveals the lack of awareness of the role of banks as a service and liquidity provider.

  For instance, a bank selling a product hedging an insurance company against the decrease of an equity portfolio (transaction 1) will have to borrow the shares of this portfolio (transaction 2) in order to sell them "short" (transaction 3). At the maturity of the client transaction, the bank purchases the shares on the market (transaction 4) in order to return them to the stock lender (transaction 5). In case of actual drop of the portfolio hedged, the result of these transactions enable the bank to pay to the insurance company an amount equivalent to the drop in accordance with the hedging transaction concluded. In such a case, the FTT would have to be paid five times, and even seven times if the collateral of the borrowed shares is also constituted of securities, representing a cost above the usual profit margin on this type of activity.

- Driven by this fear of tax evasion through the use of exemptions, most features of the FTT based on the Commission Proposal are not substantiated by any economic rationale.

  There is no economic reason for taxing, for instance, intra-group transactions, which are just a result of internal organisation without any impact on the markets, or even collaterals or guarantees, which are in essence beneficial to the financial system.

  This is also particularly obvious for derivatives, for which the notional amount has been retained as a fictitious taxable basis because there was nothing else; as a matter of fact derivatives are not investment products with a financial return. They are financial contracts which are used to adjust, hedge and redistribute the risks on the underlyings. When they are concluded, their 'value' is zero because the contract reflects equivalent commitments from both parties.

Moreover, where is the economic ground for considering any modification of derivative agreements as a taxable action (and with the same taxable basis, i.e. the notion of the contract) when the efficiency of these tools derives from the flexibility they bring in the management of the risks?

It is also difficult to see any justification in taxing repo transactions, whose use could be significantly undermined by any taxation, when they are currently a vital resource to liquidity.

- The territorial connecting factor will lead to distortion or relocation risks and/or will affect the competence of the non participating countries :

    - if based on a residence principle, whether narrow or wide, the implementation of an FTT will generate massive relocation of the activities (and of the corresponding tax basis) outside the FTT zone. However, let's look on the bright side: at least with the ECP the relocation could be within Europe;

    - if based on the issuance principle – or also on a wide residence principle , the non participating Member States will have to contribute to the collection of the FTT to the benefit of the participating Member States and, therefore, would certainly consider that such tax affects their own competence over their tax payers.

In short, the Commission's proposed FTT is a tax that 'does not work': it would destroy many financial businesses and – on top and as a consequence -- would not raise the expected funds.