III

(Preparatory acts)

EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

472ND PLENARY SESSION HELD ON 15 AND 16 JUNE 2011

Opinion of the European Economic and Social Committee on the 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Taxation of the Financial Sector'

COM(2010) 549 final

(2011/C 248/11)

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On 7 October 2010, the Commission decided to consult the European Economic and Social Committee, under Article 113 of the Treaty on the Functioning of the European Union, on the

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Taxation of the Financial Sector

COM(2010) 549 final.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 31 May 2011.

At its 472nd plenary session, held on 15 and 16 June 2011 (meeting of 15 June 2011), the European Economic and Social Committee adopted the following opinion by 102 votes to 16 with 28 abstentions.

1. **Conclusions and recommendations**

1.1 The EESC welcomes the Commission's overall initiatives aiming to help restore growth, resilience and financial stability. The stability and effectiveness of the financial sector and thus the limitation of excessive risk taking, as well as the creation of right incentives for the financial sector institutions should be ensured by appropriate regulation and supervision. In this respect, the EESC has recently expressed its support to the development of a Bank Resolution Fund scheme as part of the framework for crisis management.

1.2 In the aftermath of the crisis, governments had to engage in fiscal consolidation efforts so as to be able to face the costs of the crisis and wider social and economic consequences. The EESC is of the opinion that the financial sector should contribute to these efforts in a fair and substantial way.

1.3 As emphasised in the Commission's Communication, an increasing number of Member States have already taken unilateral measures with regard to financial sector taxation. They have adopted different taxation schemes, with different tax bases, different effective tax rates and different scopes of application. The EESC believes that the tax base for such fiscal mechanisms should be harmonised and that double taxation relief measures should be coordinated. If the Commission adopted initiatives in this way, it should take into account the divergent impacts they may have on each individual Member State, the importance and robustness of domestic financial markets, the existing domestic tax frame and the new tax this Member State may have imposed on its financial sector in the aftermath of the crisis.

1.4 New levies, requirements and regulations could have a wide range of effects on the financial system and the whole economy. Therefore, their impact on the capital base and on the capacity of banks and financial institutions to play their role in the financing of the economy and SMEs in particular should be carefully evaluated. The total tax contribution of the EU financial sector should be compared to other sectors. The

effects of additional taxes on the global competitive position of EU financial institutions have to be taken into consideration.

1.5 Since tensions on liquidity and solvency were pivotal elements in the run-up to the crisis the EESC recommends that any new tax on financial institutions should be designed in a way that takes into account the institutions' ability to pay and their ability to comply with new capital requirements.

1.6 In its impact study, the Commission should pay particular attention to the proportionality principle. This means that the administrative burden imposed on market operators and financial institutions as a result of compliance requirements should be maintained proportional to the underlying objective of this new tax. If the Commission envisaged introducing a new tax under the Financial Transaction Tax (FTT) model, then it should seek consistency with the policy it has developed in recent years to simplify tax procedures that are considered hurdles to post-trading. If it envisaged introducing a Financial Activities Tax (FAT), then the tax base should be designed in a way that is compatible with the information that is readily available to financial institutions in the existing financial reporting framework.

1.7 Whilst confirming the conclusions and recommendations presented in its opinion of 15 July 2010 in favour of the introduction of a financial transaction tax (FTT) ([1]), the EESC would like to emphasise that, given the risk of fostering the relocation of financial activities in non-EU financial centres, the introduction of a FTT at global level should be preferred over an EU-wide FTT. However, if it emerges that the adoption of a FTT at global level is not feasible, then the EESC would envisage the adoption of an EU FTT, taking into account the outcome of the European Commission impact assessment.

1.8 A Financial Activities Tax (FAT) may have similar shortcomings as the FTT, including a shifting effect. Investigations of this concern should be part of a preliminary Commission's impact study.

1.9 The introduction of a new tax based on cash flows and designed outside the scope of VAT, keeping unchanged the unsatisfactory VAT exemption regime, may create a very complex tax system for financial institutions. Therefore, subject to the outcome of the impact study to be carried out by the Commission, the EESC believes that, if a new financial sector tax were based on cash flows or based on similar factors, then the Commission should assess the merits of designing it within the VAT framework, so as to ensure an administratively easier approach for the sector and to alleviate the pain of irrecoverable VAT. Attention must also be paid to the unintended consequences the introduction of a tax on the financial sector may have, more particularly the development of alternative systems that are not subject to regulation, supervision or control and which, in turn, may cause major problems.

([1]) EESC opinion on Financial transaction tax, OJ C 44 of 11.2.2011, p.81.

1.10 The competitive implications of new taxes on the banking industry, both with regard to the competitiveness of the banking sector with the non-banking sector, and the ability of the banking industry to continue to meet the financial needs of the real economy should not be ignored. This is particularly important as the economy seeks to emerge from the recession.

2. **Context**

2.1 In the aftermath of the crisis, national governments around the world are facing a major two-fold problem. First, they urgently have to reform the financial and banking system. Second, they need new sources of revenue.

2.2 Multiple tax objectives are under consideration, including the reduction of negative externalities, consolidation of public finance, contribution of the financial sector to costs repayments, honouring of the commitments to the developing world and to combating climate change, and, assuming that the financial sector is under-taxed, making the financial sector contribute in a fair and substantial way to public budgets. So far, the aim of the financial sector taxes remains quite broad, and the nature and mechanisms of these taxes are still under examination.

2.3 On 7 October 2010, the European Commission issued a Communication on the future taxation of the financial sector ([2]), underscored by a Staff Working Document ([3]), in which two instruments are envisaged:

— A Financial Activities Tax (FAT) should be put in place at EU level in order to generate revenues for Member States' budgets and at the same time to help ensure greater stability of financial markets. It considers that if carefully designed and implemented such a FAT would not pose an undue risk to EU competitiveness.

— At global level, the Commission supports the idea of a FTT which in its view could help fund international challenges such as development or climate change.

2.4 Considering the global and systemic nature of the financial crisis, the Commission also suggests that the bank tax may have a deterrent effect against excessive risk-taking. In its view, it would adequately complement the regulatory and supervisory reforms by enhancing the efficiency, resilience and stability of financial markets and reducing their volatility.

2.5 As a part of the framework for crisis management, the Commission has also proposed initiatives including the implementation of a Bank Resolution Fund (BRF) ([4]) which has already been the subject of an EESC opinion ([5]).

([2]) COM(2010) 549/5.
([3]) SEC(2010) 1166/3.
([4]) COM(2010) 254 final.
([5]) EESC opinion on Bank Resolution Funds; OJ C 107 of 6.4.2011, p. 16.

3. **Fair and substantial contribution of the financial sector to public finance**

3.1 Due to the role that actors of the financial sector had in the run-up to the crisis, during which governments had to bail out financial institutions, the view is widespread that the related costs should not be borne by citizens or other sectors. This view is translated in the objective of 'making the financial sector contribute in a fair and substantial way to public budgets'. In this context, the Commission envisages including in its economic study an in-depth impact assessment in which various taxation options are analysed in order to produce a balanced proposal.

The EESC recommends that the Commission conduct a survey on the total tax contribution of the financial services sector in the EU, measuring all the different taxes that financial services companies already pay. This study may pick up the big picture of corporate tax payments, irrecoverable VAT and the employment taxes supported by banks as employers. Separately, the employee-based taxes should be incorporated as a measure of the wider economic contribution. Then the idea may be to verify whether there is symmetry between taxation of the banking sector and its value added and whether the overall tax contribution of the banking sector is lower or higher compared to other key sectors. Finally, an aggregation of the new bank tax with the current total tax contribution could be estimated.

3.2 The EESC believes that if a financial sector tax were to be introduced, such study would help calibrate its magnitude both in terms of scope of application and effective tax rate. It should carefully examine the banks' capacity to rebuild and strengthen their capital base and the banks' capacity to finance households and businesses, in particular SMEs, in the EU.

3.3 In the EESC's view, the proposals related to how the financial sector industry might contribute to the costs of any possible future crisis cannot be separated from the debate taking place on wider changes to the regulatory system and the vast array of measures aimed at reducing both the likelihood and impact of financial failure.

3.3.1 An optimal financial sector taxation system would be one that met the dual purpose of generating tax revenues and curtailing risk-taking in equal measure.

4. **Financial transactions tax (FTT)**

4.1 The FFT is intended to fulfil multiple purposes, in particular: to dampen unproductive activity on the financial markets by reducing speculation and volatility and at the same time to bring government money back home.

4.2 The European Parliament adopted a Resolution on the transaction taxes in March 2010 and a Report on innovative financing at global and European levels [6] in March 2011.

4.3 By applying the FTT, the authorities seek to diminish the number of risky, speculative ('socially useless') [7] financial transactions. They may also see it as helping to prevent banks from growing too big, or them undertaking too many too risky transactions in future.

4.4 The EESC expressed views on the FTT in its own initiative opinion on Financial Transaction Tax, including the following conclusions and recommendations:

— The primary objective of an FTT should be to change behaviour in the financial sector by reducing short-term speculative financial transactions. In this way the activities in the financial sector can work through the price mechanism of the market. The desired effect could be reached as the FTT hits the most frequent transactions the hardest.

— The second objective of an FTT is to raise public money. This new source of revenue could be used to support economic development in developing countries, to finance climate policies in developing countries or to alleviate the burden on public finances. The latter also implies that the financial sector will pay back public subsidies. In the long-term, revenues should provide a new general source for public income.

4.5 Since concerns have been expressed in many quarters about the risk of shift effects if the tax were introduced only locally, an FTT should first be envisaged at global level, as advocated by the Commission. However, if that proves impossible, the EESC would favour the adoption of an FTT at EU level taking into account the outcome of the European Commission impact assessment.

4.6 The EESC considers that a FTT should be designed in a way that makes its collection by central depositary systems easily applicable. Issues and costs associated with enforcing collection and compliance of a broad-based FTT should be taken into consideration, as well as legal uncertainty for presumed collectors of the tax for over-the-counter (OTC) transactions of non exchange traded securities and derivatives.

4.7 Finally, the EESC would point out that there are still many jurisdictions which constitute off-shore financial centres, whose opacity relates to their banking secrecy and their low or non-existent taxation. Given the ease with which it is possible to set up financial branches and operate via the internet in these

[6] European Parliament resolution of 10 March 2010 on financial transaction taxes – making them work and Draft Report on innovative financing at global and European level (2010/2105(INI)).

[7] *Taxing the Speculators*, http://www.nytimes.com/2009/11/27/opinion/27krugman.html.

locations, it is essential that, in parallel with the adoption of an FTT, improving transparency and effective judicial and fiscal cooperation is made obligatory.

5. **Financial Activities Tax**

5.1 The main features of the FAT when compared to an FTT are that it taxes corporations of the financial sector, whilst the FTT taxes financial market participants. Furthermore, while the FTT falls on trading activities, which are concentrated in a few financial centres, the FAT focuses on the profits and remunerations of the financial sector, which are distributed more evenly.

5.2 Referring to the IMF Report, the Commission considers that another potential instrument aimed at improving taxation of the financial sector and at reducing potentially negative externalities may be the Financial Activities Tax (FAT).

5.3 When designing a FAT, the Commission may define a tax base by reference to the financial statement.

5.4 The concepts used should be understandable in the existing accounting frameworks, whether International Financial Reporting Standards (IFRS) or local Generally Accepted Accounting Principles (local GAAP), since financial institutions may not apply IFRS.

5.5 If designed based on cash-flows, the introduction of a FAT may impact liquidity and make cash flows more expensive, whereas tensions on liquidity were a pivotal element in the run-up to the crisis. It is therefore advisable, when defining the tax base of the FAT, to pay particularly attention to the institutions' ability to pay and to their ability to comply with new capital requirements, as well as to the FAT-VAT interaction.

6. **VAT**

6.1 In the Commission's view, the introduction of a new tax is underpinned *inter alia* by the VAT exemption of financial services under the Council Directive 2006/112/EC on the common system of value added tax ('the VAT Directive').

6.2 The EESC would like to emphasise that the primary reason for the exemption is the conceptual and practical difficulty in measuring the value related to financial services rendered by banks. This is especially the case for the traditional financial intermediation services of deposits and loans. The consideration for these services is in the form of the spread between the interest charged on loans and the interest paid on deposits. This margin is a global composite measure of intermediation services rendered by a bank to both depositors and borrowers, which cannot be readily measured for individual transactions with the aim to apply VAT or any other form of transaction-based consumption tax. It has been difficult to develop a methodology for allocating this margin to individual transactions for VAT purposes under an invoice-based method. Similar issues arise in the taxation of insurance and other types of financial services, e.g. currency exchange and trading in securities.

6.3 The VAT exemption of financial services is associated in the VAT legislation with no right – or limited right – to deduct input VAT. This means that financial institutions cannot fully deduct the VAT incurred on own expenses, which therefore is a pure cost. The amount of this 'hidden VAT cost' may be significant as outsourced services and intra-group transactions suffer a cascading effect of the tax.

6.4 The Commission issued in 2007 a proposed Directive to reform the VAT treatment of financial services based on three pillars, including the proposal for an option to tax financial services. The EESC believes that the debate on the financial sector tax should not be separated from the proposed VAT reform ([8]).

6.5 The EESC is also concerned about the scope of the FAT and the cumulative burden of this tax with the amounts of irrecoverable VAT. Whilst it can be designed to specifically target economic rents and/or risk, the FAT falls on total profit and wages in its most extensive form (addition-method FAT). The EESC believes that if a new tax were based on cash flows or on similar factors, the Commission should assess the merits of designing it in the scope of VAT, so as to alleviate the impact caused by irrecoverable VAT, hence avoiding an increase of the economic cost for all economic operators in Europe.

Brussels, 15 June 2011.

The President
of the European Economic and Social Committee
Staffan NILSSON

([8]) COM(2007) 746 and 747 final.