Under the EU’s proposed Financial Transactions Tax, non-participating member states may bear the burden of deeper tax integration without reaping the benefits.

As a reaction to the financial crisis, in 2011, the European Commission developed a proposal for an EU-wide Financial Transactions Tax, with the purported aim of ensuring that the financial sector would contribute to the costs of the crisis. Christiana HJI Panayi looks at how these proposals have developed, and the use of enhanced cooperation between EU Member States, which has occurred due to the lack of unanimous agreement on the proposal. The UK is one of the chief opponents of the Financial Transactions Tax, citing concerns that financial institutions outside of the Member States participating in the Financial Transaction Tax may be subject to it, and worries about its effects on economic growth.

The UK has recently challenged the European Commission’s authorizing decision to adopt a Financial Transaction Tax (FTT) through enhanced cooperation. This is a very interesting development in the field of European taxation. There has long been a discussion on the merits of a financial transaction tax, often called the Tobin tax. Arguments in favour of such tax increased with the recent financial crisis, especially within the European Union. In 2011, the Commission published a proposal for a Council Directive introducing a common system of a Financial Transaction Tax, even though the initial intention was to work towards the introduction of an FTT on a worldwide basis.

The FTT was hailed as a levy which would ensure that the financial sector contributed to covering the costs of the crisis and that it is taxed in a fair way vis-à-vis other sectors for the future. It was also meant to dis-incentivise excessively risky activities by financial institutions and to generate additional revenue for general budgets or specific policy purposes. The FTT was not meant to affect citizens and businesses. It would only apply if one of the two parties is a financial institution and if one of the two parties – whether the financial institution or the non-financial institution – is established in a Member State. A tax of 0.1% for most financial transactions other than derivatives and 0.01% for derivatives was envisaged. These are minimum rates and participating Member States are entitled to
The term ‘financial transactions’ was defined broadly to include the sale or purchase of financial instruments, money-market instruments, units or shares in collective investment undertakings, transfers of financial instruments between group entities and the conclusion or modification of derivatives. Transactions on the primary market were exempt. Some other transactions were not included, for example, spot currency transactions, ‘consumer transactions’ (e.g. concluding insurance contracts, mortgage lending), the issuing of government bonds and transactions with certain bodies (e.g. transactions with the central banks of Member States).

‘Financial institutions’ were broadly defined and comprised of all financial institutions and SPVs, as well as certain non-financial companies where a significant part of their overall activities was financial. Very importantly, a financial institution would be deemed to be established in a Member State under a number of criteria (e.g. where the financial institution has been authorised to act as a financial institution, where it has its registered seat or its permanent address or usual residence, where it has a branch etc). Therefore, under certain circumstances, non-EU financial institutions would also be deemed EU-established. There was an escape clause in that no FTT would be levied where there was no link between the economic substance of the transaction and the territory of any Member State.

Each financial institution that is a party to the financial transaction would pay the FTT and there would be joint and several liability. Transfers of financial instruments within a corporate group would also be subject to FTT, possibly having a cascading effect. The administration of the FTT was largely left for the Member States to determine, making use of administrative cooperation tools. In March 2012, the Commission proposed to split the revenues from the tax 2/3 to the EU Budget and 1/3 to Member States.

This proposal was not favourably seen by a number of Member States such as the UK, Sweden, Bulgaria, the Czech Republic, Cyprus, Malta and Denmark. By June 2012 at the Economic and Financial Affairs Council (ECOFIN) meeting, it became clear that the Commission’s proposal for an EU FTT had not amassed the necessary support to be unanimously adopted by all Member States. Therefore, interested Member States had to look for alternative ways, such as the use of the enhanced cooperation procedure set out under the EU Treaties.

Under enhanced cooperation, a minimum of nine Member States can adopt a legislative measure between themselves even if not all Member States want to do so. Enhanced cooperation can only be used as a measure of last resort. The proposed measure has to comply with EU law and must not undermine the internal market, create barriers in trade or discriminate between Member States or distort competition. While the competences of non-participating Member States have to be respected and acts adopted in the framework of this procedure only bind participating Member States, at the same time, non-participating Member States are under an obligation not to impede the implementation of the legislation under enhanced cooperation.

Member States wanting to adopt legislation through enhanced cooperation have to send the request to the Commission, specifying the scope and objectives of the enhanced cooperation proposed. Authorisation shall be granted by the European Council after a proposal is made by the Commission and consent is obtained from the European Parliament. So far, enhanced cooperation has been used to adopt conflict of laws rules in relation to divorce law in 2010 and to establish the unitary patent protection system in 2012.

The adoption of the FTT through enhanced cooperation was instigated mainly by Germany and France and was eventually supported by the Commission in October 2012 who advised the Council to approve it. The FTT proposal, eventually backed by 11 Member States (Austria, Belgium, Finland, France, Germany, Greece, Italy, Portugal, Spain, Slovenia and Slovakia) was approved by the European Parliament in December 2012. In the January ECOFIN Council, the adoption of the FTT through enhanced cooperation was approved by qualified majority. The UK, Luxembourg, Malta and the Czech Republic raised concerns that the Commission had not provided any analysis of the impacts that an enhanced cooperation FTT would have on individual Member States. The dissenting Member States abstained from voting. The UK also tabled a minute statement stating that it could not support the proposal as it could not take a view whether the conditions of enhanced cooperation were met.
Nevertheless, on 14 February 2013, the Commission adopted a proposal for a Council directive implementing enhanced cooperation in the area of financial transaction tax, accompanied by an Impact Assessment. The revenue estimate was €30-35 billion annually. Part of this would be added to the EU Budget directly as an own resource, reducing the contributions of participating Member States accordingly. This proposal needs to be unanimously approved by the participating Member States to be adopted by them.

The most important change compared to the original 2011 proposal is the introduction of the issuance principle, whereby financial instruments issued in the participating Member States will be taxed when traded, even if the parties trading them are not established in FTT Member States. This principle is thought to be the most contentious recommendation as in certain circumstances it could have extraterritorial effects. For example, FTT will be due when a bank established in Hong Kong buys shares originally issued in Germany from a bank in the USA. Both banks would be subject to FTT as the shares were issued in Germany.

UK objections to the FTT

The Commission’s revised proposal was met with disapproval in the UK. In a letter published on 26 March, the House of Lords’ European Union Committee (the Committee) urged the UK to challenge the authorising decision, criticising the ‘paucity of thinking’ in the FTT proposal.

The Committee asked for clarifications on the obligation of the UK authorities to collect the FTT and the ensuing costs. The Committee was of the opinion that under the proposal, UK financial institutions would be burdened with the obligation to pay the FTT when financial transactions are entered into with financial institutions in participating Member States. The FTT levy could be collected through the EU’s mutual assistance mechanisms or as a result of the provisions on joint and several liability set out in the proposal. Even more far-reaching consequences would apply with the application of the issuance principle as the UK might be jointly and severally liable for the FTT payable by financial institutions outside of the EU, in case of transactions involving financial instruments issued in participating Member States.

Another criticism levied against the revised proposal was the uncertainty as regards the use of potential revenue from the FTT. The fact that revenue collected, for example, by the UK could be used as a new own resource for the EU Budget, resulting in a corresponding reduction of the national contributions of participating Member States was dissatisfactory. The Committee also commented on the fact that the Commission had not given much information about the implications of the proposal for non-participating Member States and argued that the Impact Assessment did not adequately address the potentially deleterious effect of the FTT on economic growth. The UK Government was also accused of complacency and was urged to cooperate with the other non-participating Member States to try and avert the worse consequences of this proposal. Given the continuous US hostility to the proposal, the Committee also remained unconvinced that an EU-wide FTT would pave the way for the introduction of a global tax.

This highly critical letter must have had some influence on the UK Government’s decision shortly thereafter, on 18 April, to challenge the authorising decision to adopt the FTT through enhanced cooperation at the Court of Justice. An HM Treasury spokesman emphasised that the UK is not against the principle of a global financial transactions tax, “but think that a European-only tax would hit people’s savings and pensions and hit jobs and growth”. While the UK would not participate in a Europe-only tax, “we have also said we will not stand in the way of other countries, but only if the rights of countries not taking part are respected”. This challenge has been lodged because it is believed that the proposal currently on the table does not meet these requirements.

At the time of writing, details of the legal case are yet to be published but it is thought that the challenge is based on the extraterritorial impact of the FTT and the imposition of expenses on non-participating Member States. The latter concern is due to the fact that the revised proposal does not contain any provision for the reimbursement of expenses incurred by non-participating Member States through the collection of the tax.

This is going to be a very interesting case. Not only is it the first time that enhanced cooperation is being used in the
area of taxation but it is also the first time that is being challenged by only one of the (many) non-participating Member States. There could also be more general constitutional implications. While the existence of the fiscal veto has always been criticised for stifling further tax integration in the EU, especially in the area of direct taxation, the perils of partial integration should not be underestimated. The developments surrounding the FTT are a good illustration of this. They show the potential of enhanced cooperation increasing the chances of non-participating Member States bearing the burdens of deeper tax integration without reaping the benefits. Furthermore, as the use of the enhanced cooperation procedure is still at an embryonic stage, there are still concerns as to the level of consultation that should be undertaken during the process. It is noteworthy that two out of the three times it has been used so far there has been a challenge by a non-participating Member State on the basis that its requirements were not met.

The FTT proposal is a very controversial project. It would have been preferable if it was not introduced through enhanced cooperation – a process highly contentious itself. This combination is unlikely to yield the best possible results. Recent developments seem to corroborate that.

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