The Tobin Tax : recent developments

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At various times over the last thirty years politicians, economists and bankers have debated the case for introducing new taxes on financial transactions, following a proposal by the American economist James Tobin that a tax on currency trades could dissuade harmful speculation by financial markets.

For many the need for a 'Tobin Tax' was shown by the banking crisis in late 2007 and its devastating impact on the world economy. Taxpayers in many countries have provided considerable sums to bail out individual companies and restore stability to the global system – and new taxes on the banking system would appear to be a fair way of recovering these costs. In addition the ability of some of the largest banks to return to robust financial health, and to reward their top personnel handsomely, has increased the political pressure for a change – seen in the popularity of the campaign launched in early 2010 for a Tobin-like 'Robin Hood Tax'.

For the next two years the case for some form of international levy on the banking system was explored by the International Monetary Fund and discussed by the G20 nations – culminating in the G20 summit held in Cannes in November 2011, but without a consensus being reached. In September 2011 the European Commission published proposals for an EU-wide tax on financial transactions (FTT). Although this idea received support from some EU States, the Coalition Government has been strongly opposed, on the grounds that such a tax would only be viable if implemented on a global scale, and that the UK's own banking levy, which was introduced in January 2011, meets many of the aims set for an FTT without some of its possible drawbacks. Other countries have also raised concerns, and in June 2012 European Finance Ministers agreed that the measure would not be proceeded with.[1]

In October 2012 eleven Member States agreed to pursue the option of having a Tobin-like levy on a smaller scale.[2] Under the procedure of 'enhanced co-operation', if Member States have failed to obtain an objective within a reasonable period of time, a minority of countries may pursue a proposal, provided at least nine States participate. This use of this procedure was approved in January 2013, and the Commission published draft provisions the following

[1] HC Deb 2 July 2012 c30WS; see also, "Plans for EU-wide financial transaction tax shelved", *Financial Times*, 23 June 2012

[2] ECOFIN press notice 14469/12, *3189th Council Meeting*, 9 October 2012 p6

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month.[3] Although the UK is not one of the eleven participating Member States, in April 2013 the Government confirmed that it would launch legal action against the initiative, on the grounds that, in its current form, it would override the rights, competencies and obligations of the Member States who were not participating, and, as such, fail to meet the conditions established in the Treaty for 'enhanced cooperation'. Treasury officials are reported to be confident that negotiations could ensure that a final FTT did not affect financial institutions outside the eleven States, but that making a legal challenge at this early stage would ensure that the UK could pursue the option, if this assessment proved over-optimistic.[4]

This note focuses on these developments, while a second note gives more historical background on the case that has been made for introducing new taxes on the banking system and financial transactions.[5]

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1 The IMF's work on taxing financial institutions

In the aftermath of the international banking crisis a number of regulators, economists and political leaders argued that some new form of tax on the banking sector should be considered, whether to prevent the recurrence of excessive pay and bonuses for bankers, to discourage speculation that might threaten a further crisis, or to recoup some of the cost of public bailouts to failed banks. In November 2009 the then head of the International Monetary Fund, Dominic Strauss-Khan, confirmed that the IMF had been asked by the G20 nations to look at the issue,[6] and in April 2010 the IMF released an interim report on the possible introduction of both a flat rate levy on banks, and a tax on their activities, based on both profits and pay. The report's executive summary summarised the two taxes as follows:

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[3] ECOFIN press notice 5555/13, 22 January 2013 & COM (2013) 71 Final, 14 February 2013. See also, European Commission press notice IP/13/115, 14 February 2013. Further details are collated on the Commission's site.

[4] "Osborne challenges EU Tobin tax", *Financial Times*, 20 April 2013; European Scrutiny Committee, *Fortieth report*, 2 May 2013 HC 86-xxxix 2012-13 para 2.7-2.11

[5] *The Tobin Tax : earlier debates*, SN1346,16 January 2012

[6] "G20 pressure forces IMF chief to rethink opposition to FTT", *Guardian*, 24 November 2009

> A "Financial Stability Contribution" (FSC) linked to a credible and effective resolution mechanism. The main component of the FSC would be a levy to pay for the fiscal cost of any future government support to the sector. This component could either accumulate in a fund to facilitate the resolution of weak institutions or be paid into general revenue. The FSC would be paid by all financial institutions, with the levy rate initially flat, but refined over time to reflect institutions' riskiness and contributions to systemic risk—such as those related to size, interconnectedness and substitutability—and variations in overall risk over time.
>
> Any further contribution from the financial sector that is desired should be raised by a "Financial Activities Tax" (FAT) levied on the sum of the profits and remuneration of financial institutions, and paid to general revenue.

The report went on to note:

> International cooperation would be beneficial, particularly in the context of cross border financial institutions. Countries' experiences in the recent crisis differ widely and so do their priorities as they emerge from it. But none is immune from the risk of a future—and inevitably global—financial crisis. Unilateral actions by governments risk being undermined by tax and regulatory arbitrage. Effective cooperation does not require full uniformity, but broad agreement on the principles, including the bases and minimum rates of the FSC and FAT. Cooperative actions would promote a level playing field, especially for closely integrated markets, and greatly facilitate the resolution of cross-border institutions when needed.[7]

The report went on to argue that a Tobin-like tax on financial transactions – FTT for short – would not prevent financial instability and would be too easy to pass on to customers – although the administration of this kind of charge was not a fundamental obstacle:

> Collecting taxes on a wide range of exchange-traded securities (and, possibly, derivatives) could be straightforward and cheap if withheld through central clearing mechanisms, as the experience with the UK stamp duty [set at 0.5% on locally-registered shares] shows. Certainly the widespread use of a few clearance and settlement systems is helpful for the implementation of transaction taxes more generally. Of course, some important practical issues are not yet fully resolved. Questions remain, for example, as to whether such a tax might drive transactions into less secure channels. But implementation difficulties are not unique to [a tax on financial transactions: the FTT], and sufficient basis exists for practical implementation of at least some form of FTT to focus on the central question of whether such a tax would be desirable in principle …
>
> [However] … **an FTT does not appear well suited to the specific purposes set out in the mandate from G-20 leaders** …
>
> It would ***not be the best way to finance a resolution mechanism*** of the kind discussed above, since the volume of transactions is a poor proxy for either the benefits it conveys on particular institutions or the costs they are likely to impose on it.
>
> It is ***not focused on core sources of financial instability***. An FTT would not target any of the key attributes—institution size, interconnectedness, and substitutability—that give rise to systemic risk. (Adjusting the rate of tax to reflect such considerations

[7] IMF, *A fair and substantial contribution by the financial sector: Interim Report for the G20*, April 2010 p3. See also, "IMF proposes two big new bank taxes to fund bail-outs", BBC News online, 21 April 2010

> would be possible in principle, but highly complex in practice; more generally, if the aim is to discourage particular types of transactions, this could be done more effectively by taxing or regulating them directly) …
>
> Its ***real burden may fall largely on final consumers rather than, as often seems to be supposed, earnings in the financial sector***. No doubt some would be borne by owners and managers of financial institutions. But a large part of the burden may well be passed on to the users of financial services (both businesses and individuals) in the form of reduced returns to saving, higher costs of borrowing[8] and/or increases in final commodity prices. Indeed, this is more likely the more general the adoption of the tax, since that helps industry pass on the cost to its customers.
>
> Because it is levied on every transaction, the cumulative, 'cascading' effects of an FTT—tax being charged on values that reflect the payment of tax at earlier stages—can be significant and non-transparent. It is far from obvious that the incidence would fall mainly on would increase the cost of capital by 10–180 basis points. either the better-off or financial sector rents.[9] In sum, while the incidence of an FTT remains unclear—as with other taxes considered in this report—it should not be thought of as a well-targeted way of taxing any rents that may be earned in the financial sector.[10]

Initial reactions to the report were strongly divided, with the UK and US reportedly positive about these ideas, while other countries, such as Canada and Japan, being ambivalent at best, if not strongly opposed.[11]

In the summer the IMF published a follow-up report,[12] and in this, raised concerns about the impact that a tax on financial transactions might have:

> No doubt some would be borne by owners and managers of financial institutions. But a large part of the burden may well be passed on to the users of financial services (both businesses and individuals) in the form of reduced returns to saving, higher costs of borrowing and/or increases in final commodity prices. Indeed, this is more likely the more general the adoption of the tax, since that helps industry pass on the cost to its customers. Because it is levied on every transaction, the cumulative, 'cascading' effects of an FTT—tax being charged on values that reflect the payment of tax at earlier stages—can be significant and non-transparent. It is not obvious that the incidence would fall mainly on either the better-off or financial sector rents. In sum, while the incidence of an FTT remains unclear—as with other taxes considered in this report—it should not be thought of as a well-targeted way of taxing any rents earned in the financial sector.[13]

The authors reiterated the case, made in their interim report, that it would be preferable for governments to impose some form of fixed levy, to compensate taxpayers for the support they had provided the banking system, and/or a tax on financial activities.

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[8] Schwert and Seguin (1993), for example, estimate that a 0.5 percent securities transactions tax in the U.S.

[9] Most current proponents of an FTT do not envisage that its base would include current account bank transactions, but it is cautionary to recall that while some had advocated this as a relatively progressive form of taxation, such evidence as there is suggests the opposite: Arbeláez, Burman, and Zuluaga (2005).

[10] *A fair and substantial contribution by the financial sector …*, April 2010 pp15-17

[11] "IMF puts forward plans for two global bank taxes" & "Nations struggle to find consensus on bank taxes", *Financial Times*, 21 & 24 April 2010

[12] The paper, published in June, is collated with other material in, *Financial Sector Taxation - The IMF's Report to the G-20 and Background Material*, September 2010

[13] *op.cit.* pp18-19

2 The UK's Bank Levy

While discussions about new global taxes on the banking system continued, the new Conservative Liberal-Democrat Government took office in May 2010, and in its first Budget the next month, announced that a new bank levy would be introduced in the UK from January 2011. The levy would be based on banks' balance sheets, and is intended to encourage banks to move to less risky funding profiles. When the Chancellor, George Osborne, described the new levy in his Budget statement to the House, he also said that the Government would explore the merits of a tax on financial activities, while noting that this type of reform was dependent on achieving international consensus for such a tax:

> The failures of the banks imposed a huge cost on the rest of society, so I believe that it is fair and right that in future banks should make a more appropriate contribution, reflecting the many risks that they generate. Such an approach has already been recommended by the International Monetary Fund. We are exploring the costs and benefits of a financial activities tax on profits and remuneration, and we will work with international partners to secure agreement, but today the British Government take the initiative in this global debate about the appropriate risks and rewards in international banking.
>
> From January 2011, we will introduce a bank levy. It will apply to the balance sheets of UK banks and building societies, and to the UK operations of banks from abroad. There will be deductions for tier 1 capital and insured retail deposits, and a lower rate for longer maturity funding. Smaller banks with liabilities below a certain level will not be liable for the levy. Once fully in place, we expect the levy to generate over £2 billion of annual revenues.
>
> There are those who have argued whether we should wait until every country in the G20 introduces a bank levy. I believe that is not reasonable or fair. Indeed, I can tell the House that the French and Germans have joined the UK today in committing to introduce a bank balance sheet levy. In a joint statement, our three Governments have pledged to ensure our banks make a fair contribution to reflect the risks they pose.[14]

Initially the Government anticipated that the levy would raise just over £2.3 billion by 2012/13;[15] following some changes to its design, the levy is now estimated to raise £1.6 billion in 2012/13, and around £2.9 billion each year over the following four years.[16] Some commentators contrasted the expected receipts from the levy from the much larger sums which supporters of the Robin Hood Tax campaign believe that Tobin taxes would deliver: as the Guardian's economics editor, Larry Elliott noted at this time:

> The sense that the budget was less fair than it looked was underlined by the soft-touch approach to the City. The increase in capital gains tax was smaller than expected and the £2bn bank levy was hardly suitable punishment given the role of the financial sector in Britain's most grievous post-war recession. Campaigners for a so-called Robin Hood tax said Osborne could have raised £20bn through a financial transaction

[14] HC Deb 22 June 2010 cc 175-6

[15] *Budget 2010* HC 61 June 2010 p40

[16] Office of Budget Responsibility, *Economic and fiscal outlook*, Cm 8573 March 2013 p102 (Table 4.7). The new levy is examined in more detail in another Library note: *Taxation of banking*, SN05251, 27 March 2013.

> tax - enough to pay for the £12bn he will raise from pushing up VAT to 20% with plenty to spare.[17]

In light of the IMF's work during 2010 on an FTT, the Treasury set out the UK's position on 'Robin Hood' taxes in a statement on their site – arguing that its findings had endorsed its approach:

> The Government is aware that there is a strong lobby for the creation of a financial transactions tax (FTT) that would see a small fee imposed on trades in various financial asset classes to raise money to pay for overseas development assistance, climate change or to help tackle the current budget deficit. Foremost amongst these proponents has been The Robin Hood Tax campaign.
>
> The Government also thinks that it is right for banks to make a contribution to the public purse. The International Monetary Fund (IMF) has recently published their report, A Fair and Substantial Contribution by the Financial Sector, which was commissioned by the G20. The report endorses the type of bank levy model that the UK recently announced at its Emergency Budget on 22nd June and which the Chancellor has made clear will be implemented in the UK with effect from the beginning of next year.
>
> The Levy offers an effective way forward and ensures that banks make a contribution in respect of the risks they pose to the UK financial system and wider economy. The report also endorses a Financial Activities Tax (FAT) levied on the sum of certain profits and remuneration in the financial sector. As announced in the Emergency Budget we are currently examining the costs and benefits of a FAT and will continue to work with international partners monitoring developments in this area. However, the report doesn't offer an endorsement of a FTT and clearly there would need to be further discussion around whether the FTT model offers a stable and efficient mechanism.
>
> The Government remains totally committed to the international development agenda. The UK remains on target to reach its international commitment for Overseas Development Assistance of 0.7% of Gross National Income, an important commitment for the Coalition Government.[18]

3 Discussions among the G20

Over the next two years the IMF's work on the possible tax reform for financial institutions – including a Tobin-like tax on financial transactions – has fed into discussions among the G20 nations – but without resulting in any agreement. In June 2010 finance ministers from the G20 nations met in Korea, and the summit's final communiqué was lukewarm on the issue:

> [We] agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the banking system or fund resolution. To that end, recognizing that there is a range of policy approaches, we agreed to develop principles reflecting the need to protect taxpayers, reduce risks from the financial system, protect the flow of

[17] "Emergency budget 2010: The axeman cometh", *Guardian*, 23 June 2010
[18] HM Treasury, *Robin Hood Tax*, 4 August 2010

> credit in good times and bad, taking into account individual country's circumstances and options, and helping promote level playing field.[19]

As the *Financial Times* reported, the rather bland language used was indication of a serious division of opinion between countries:

> The communiqué attempted to disguise the rift that had occurred [at the G20 meeting] and the end of the road for a uniform global banking levy. It stated that there was "a range of policy approaches" that countries would adopt to protect taxpayers, but added that this range would be determined "taking into account individual countries' circumstances and options". Officials made it clear that the language implied countries had leeway to do what they liked.
>
> The G20 did nevertheless agree that where taxpayers have had to support banks, the principle should be that the financial sector should pay that money back. The finance ministers' communiqué stated: "The financial sector should make a fair and substantial contribution to-wards paying for any burdens associated with government interventions, where they occur, to repair the banking system or fund resolution." … Such is the political need in many countries to have a punitive tax on banks that the US, UK, Germany and much of the European Union still want individual banking levies … The result of the wrangling is that countries are still going ahead with their plans but few expect any banking levy to be large or to raise a significant sum … Given the opposition of Canada, the Toronto summit is highly unlikely even to make progress on resolving the remaining difficulties of introducing voluntary banking levies where countries agree on their merits.[20]

In January 2011, the French Government announced it would seek to promote the international adoption of a financial transactions tax, as part of its Presidency of the G20. One of the aims of its Presidency was to be "working on behalf of development", and as part of this, the Government stated it would "bring discussions on development financing to G20 level, via innovative financing and in particular a tax on financial transactions."[21] In a speech President Sarkozy gave at this time, he said, "France considers that this tax is morally sound, given the financial crisis we have just been through, that this tax is useful to dissuade speculation … and that this tax is effective for finding new resources for development."[22] As it transpired, despite a campaign by economists from several countries supporting reform,[23] the French Presidency came to be dominated by other issues – such as the troubles affecting the Eurozone.

At the G20 summit held in Cannes in November 2011 Bill Gates, philanthropist and former head of Microsoft, presented a report on development which noted that public funds could be raised from taxing financial transactions, but also from taxes on tobacco, and on shipping & aviation fuel.[24] In an interview with the *Financial Times* at the summit Mr Gates commented,

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[19] G20, *Meeting of Finance Ministers and Central Bank Governors, Busan, Republic of Korea*, 5 June 2010. At a summit in Toronto later that month, the G20 nations noted that there were "a range of policy approaches to" making sure the financial sector made a "fair and substantial contribution … Some countries are pursuing a financial levy. Other countries are pursuing different approaches." (G20, *The G-20 Toronto Summit Declaration*, 26/27 June 2010 para 21)

[20] "An idea that was hot, but now is not", *Financial Times*, 25 June 2010

[21] G20, *Presentation of the French Presidency of the G20 & G8*, 14 January 2011 p4

[22] G20, *Address by Mr Nicolas Sarkozy to present the presidency of the G20 and G8*, 14 January 2011

[23] "Robin Hood tax: 1,000 economists urge G20 to accept Tobin tax", *Guardian*, 13 April 2011

[24] Gates Foundation, *Innovation With Impact: Financing 21st Century Development*, November 2011 pp12-13

"it's fair to say that the countries here are not going to co-ordinate tax policies. That's not realistic."[25] The lack of consensus was underlined in the summit's communiqué:

> We agree that, over time, new sources of funding need to be found to address development needs. We discussed a set of options for innovative financing highlighted by Mr Bill Gates, such as Advance Market Commitments, Diaspora Bonds, taxation regime for bunker fuels, tobacco taxes, and a range of different financial taxes. Some of us have implemented or are prepared to explore some of these options. We acknowledge the initiatives in some of our countries to tax the financial sector for various purposes, including a financial transaction tax, inter alia to support development.[26]

A few days later in a statement to the House on the outcome summit, the Prime Minister reiterated the Government's opposition to anything other than a global tax on this kind: "I have been clear all along that we are not opposed in principle to such a tax if one could be agreed at the global level, but we will not unilaterally introduce a new financial transactions tax in the UK … If other countries want to introduce new financial taxes at home, including to raise revenue for development, that is for them to decide."[27]

4 An EU-wide tax on financial transactions

4.1 The Commission's review in 2010

In October 2010 the European Commission published an assessment of the options for taxing the financial sector[28] – and in the accompanying staff working document, the authors suggested that, "given the complexity of some financial transactions, the impact of a transaction tax and the feasibility of such a tax remain largely uncertain in many cases. Given this complexity, there may be considerable unintended effects and the possibilities of circumvention of the tax increase with the complexity of the operation."[29] Further to this the authors addressed the issue of the incidence of this type of tax – which, clearly, would be critical to its final impact:

> *Tax Incidence – Would the Financial Sector carry the burden?*
> There is no empirical evidence on the real incidence of a FTT. Transactions taxes are under the political and public spotlight because they are perceived as a contribution of the highly speculative financial institutions to the costs of the financial crisis. However, there is often a difference between the legal tax payer (legal incidence) and the economic agent who actually carries the economic burden of a tax (economic incidence). In the context of a Financial Transactions Tax, the economic incidence of the tax could fall either on traders, on stock exchanges, on companies and governments (via higher capital costs) or on final consumers via higher prices for financial services.
>
> For evaluating the distributional aspects of the tax, a starting point is to analyse whether the tax is progressive (i.e. it taxes the rich proportionally more than the poor or

25 "Gates cool on Robin Hood tax to help poor", *Financial Times*, 4 November 2011
26 G20, *Cannes Summit Final Declaration*, 4 November 2011 para 82
27 HC Deb 7 November 2011 c24
28 The Commission's work on this issue is collated at: http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.htm
29 SEC(2010) 1166/3 p14

> less wealthy). Unfortunately, such empirical analyses are currently unavailable, because of a lack of data. It is often argued that the tax could potentially have progressive properties since rich people are supposed to hold, and therefore trade, more than poorer ones. However, it cannot be taken for granted that this assumption necessarily holds since it also concerns the activities of financial intermediaries such as pension funds, which also manage the savings of middle- and lower-income earners.[30]

The Commission's report was the subject of a debate in the House in February 2011.[31] During the debate the then Financial Secretary, Mark Hoban, suggested that a tax might well have a detrimental impact on the UK's financial sector if introduced unilaterally – taking issue with Kelvin Hopkins, who had argued in favour of this reform:

> The hon. Member for Luton North has suggested that a financial transaction tax would not be distorting. It is worth focusing on that: he argues that it would cause little distortion because it would be levied at a low rate on a broad base. Such an argument is not persuasive, however, according to the IMF. If the central principle—the sole policy objective—is to raise revenue, taxing transactions between businesses, which is what many financial transactions are, is unwise. Distorting business decisions reduces total output, so more could be raised by taxing output directly. A tax levied on transactions at one stage cascades into price at all further stages of production …
>
> In the UK financial services sector, processing centres are a source of employment. Such centres employ people who process the transactions that are booked here—such as JP Morgan Chase in Bournemouth, Deutsche Bank in Birmingham, Citibank in Belfast, and others. They process transactions on a global basis and their employees are drawn from the local work force. Such people are not necessarily earning high incomes—they are not fat cats. A direct employment benefit comes from processing those transactions here, but the hon. Gentleman argues for a tax that would drive those jobs and transactions offshore.[32]

The Minister said a little more on the issue at the report stage of the Finance Bill on 5 July, when John McDonnell MP put down an amendment to require the Government to produce a review on such a tax; in resisting the amendment Mr Hoban argued that there was "sufficient work going on to explore the issue in significant detail":

> The hon. Member for Hayes and Harlington … is right to highlight the importance of funding international development, on which there is cross-party consensus. The Government agree that we should move to ensure that 0.7% of gross national income should be for aid. The hon. Gentleman is also right to highlight the importance of achieving the millennium development goals. … These are important issues, but we need some discussion about whether the financial transaction tax model offers a stable and efficient mechanism to raise revenue. Such taxes remain the subject of ongoing debate at international level, and the UK continues to take an active role in the discussions.
>
> The hon. Gentleman called for a review. There is no shortage of reviews on the issue. The IMF has had a review and the EU has had reviews, but they all come back to the fundamental problem with the proposal: a tax would need to be applied globally to prevent the relocation of financial services. If implemented only at UK or EU level, the

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30 *op.cit.* p15

31 European Committee B, 7 February 2011

32 *op.cit.* cc19-20

tax would simply prompt the relocation of financial services, and so fail to deliver the desired outcome in terms of revenue. In doing so, it would have significant adverse impacts on employment and the wider economy …

The European Commission is due to publish an impact assessment on further financial sector taxation, including transaction taxes, in the next few months. The House will be aware that, ahead of this, the Commission last week published its latest communication on the EU budget. This proposes that the EU budget could in future be part-funded through new taxes, including a financial transaction tax. I hope the House is also aware that this Government's position is clear: we oppose any new EU taxes to fund the EU budget.

… We have not ruled out a financial activities tax. We are engaged in discussion with our international partners and we have pressed for the Commission to consider such a tax. It is working on that. We are making progress. Another review is not needed; there is sufficient work going on to explore the issue in significant detail.[33]

4.2 The Commission's proposals : autumn 2011

In September 2011 the Commission published proposals for a financial transactions tax, to apply to "all transactions on financial instruments between financial institutions when at least one party to the transaction is located in the EU." The Commission set out its rationale for the new tax, and gave details of its scope in a press notice and accompanying memo:

The Commission has decided to propose a new tax on financial transactions for two reasons.

- First, to ensure that the financial sector makes a fair contribution at a time of fiscal consolidation in the Member States. The financial sector played a role in the origins of the economic crisis. Governments and European citizens at large have borne the cost of massive taxpayer-funded bailouts to support the financial sector. Furthermore, the sector is currently under-taxed by comparison to other sectors ...
- Second, a coordinated framework at EU level would help to strengthen the EU single market. Today, 10 Member States have a form of a financial transaction tax in place. The proposal would introduce new minimum tax rates and harmonise different existing taxes on financial transactions in the EU. This will help to reduce competitive distortions in the single market, discourage risky trading activities and complement regulatory measures aimed at avoiding future crises. The financial transaction tax at EU level would strengthen the EU's position to promote common rules for the introduction of such a tax at global level, notably through the G20.

The revenues of the tax would be shared between the EU and the Member States. Part of the tax would be used as an EU own resource which would partly reduce national contributions. Member States might decide to increase the part of the revenues by taxing financial transactions at a higher rate.[34]

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[33] HC Deb 5 July 2011 cc 1419-20. The Minister reiterated the position briefly in a written answer a few days later: HC Deb 11 July 2011 c24W.

[34] European Commission press notice IP/11/1085, *Financial Transaction Tax: Making the financial sector pay its fair share*, 28 September 2011

How will the tax work?

Who will be taxed? The main taxpayers would be financial institutions operating financial transactions, i.e. banks, investment firms, other financial institutions like insurance companies, stockbrokers, pension funds, undertakings for collective investment in transferable securities, alternative investment funds like hedge funds, etc.

Which transactions will be covered? The Commission has proposed that the tax would be levied on all transactions on financial instruments between financial institutions, if at least one of the financial institutions was deemed to be established in the European Union. The financial instruments in question would be products such as shares, bonds, derivatives and structured financial products. Whether transactions were carried out on organised markets or over the counter would not make any difference - in both cases they would be taxed.

Which transactions will be excluded from the proposed tax? Only transactions related to financial instruments would be covered by the Commission's proposal. This means all transactions in which private households or SMEs were involved would fall out of the scope of the tax. For instance, house mortgages, bank borrowing by SMEs, or contributions to insurance contracts would not be included. Spot currency exchange transactions and the raising of capital by enterprises or public bodies, including e.g. public development banks through the issuance of bonds and shares on the primary market, would not be taxed either ...

Which tax rates will be proposed? In order to reduce the risk of market disruptions, the Commission has proposed to impose a very low tax rate on transactions. It has proposed a minimum tax rate for the trading of bonds and shares of 0.1% and 0.01% for derivative products. Member States would be free to apply higher rates. The tax would have to be paid by each party to a transaction…

How will the revenue be collected? The tax would be paid immediately by financial institutions to Member States on the basis of the transactions undertaken, before netting and settlement. These are normally electronic transactions, in which case the tax would be paid the same day it was due. If the transaction is not processed electronically, the financial transaction tax would be due within three working days so as to allow the manual processing of transactions while avoiding unjustifiable cash-flow advantages.

The financial institutions that are liable to pay the financial transaction tax would have to submit a return to tax authorities. Member States would have to take appropriate measures to prevent tax evasion. Measures would include registration of financial institutions, accounting and reporting to ensure payment, keeping relevant data on financial transactions at the disposal of tax authorities and verifying the correct payment of the tax.[35]

In its impact assessment the Commission suggested that the tax could raise around €37 billion a year – which would be of the order of £32 billion. (Both the Commission and its President, José Barroso, of the Commission, also gave the much higher estimate of €57 billion.[36] In its submission to the European Scrutiny Committee, the Treasury suggests that

[35] European Commission MEMO/11/640, *Common Rules for a Financial Transaction Tax – Frequently Asked Questions* , 28 September 2011

[36] *European renewal – State of the Union Address 2011*, SPEECH/11/607, 28 September 2011; European Commission MEMO/11/640, *Common Rules for a Financial Transaction Tax – Frequently Asked Questions* , 28 September 2011

the difference between the two estimates, "may be due to the assessment assuming total tax rates of 0.1% for equity and bond trades and 0.01% for derivative trades, while the Commission assumes these rates apply to both sides of the transaction."[37]) However, as the Commission made clear in their impact assessment – any estimate would vary considerably based on the assumptions made about the behavioural responses to a tax being introduced, and in particular, the relocation of sales in derivatives to outside the EU:

> The main difference between the figures [presented in the impact assessment] and other recent estimates published elsewhere is the assumption about the reaction of derivatives markets to taxation. We draw two scenarios. In scenario (1) it is assumed that derivative trading will largely disappear (a decrease of 90% in turnover). In scenario (2) it is assumed that the derivatives trading is reduced by 70% which is in line with figures presented by Schulmeister (2011)[38] for a tax rate of 0.05%…
>
> Relocation here reflects both the move of activities elsewhere outside of the taxing jurisdiction and the disappearance of some types of activities. Such disappearance could be seen as positive if the activities targeted are considered as harmful …
>
> These assumptions on elasticities and decrease in volumes of transactions are based on the results of the review of the empirical economic literature …. It shall be stressed however that they are subject to uncertainties and caveats. The estimates shall therefore be treated with due caution. In particular, taking into account the reduction in the derivatives component of the base – which might be substantial but is highly uncertain ex ante – and other market reactions, the potential revenues from a broad-base FTT could range between EUR 16.4 billion and slightly over EUR 400 billion in 2010 (or 0.13% and 3.5% of the EU-27 GDP for 2010) depending on the hypotheses chosen for the tax rates, and the magnitude of the evasion and relocation effects ....
>
> The baseline estimates with a tax rate of 0.01% and an elasticity of 1.5 generates between EUR 17.9 billion (or 0.15% of GDP) and EUR 36.2 billion (0.30% of GDP) depending on the reaction assumed for derivatives trading. The smallest contribution is expected from an FTT on the issuing and trading with equity and bonds, which would generate EUR 1.8 billion (0.01% GDP).[39]

In addition there would be the question of a wider economic impact from the tax having a knock-on impact on economic growth, and the associated reduction in other tax revenues:

> While both [a tax on financial transactions, and a 'FAT' – a tax on financial activities, levied on profits and remuneration of financial institutions] … can be seen as effective instruments to raise revenues, one should note again that the uncertainty about the real revenue potential is large given the number of unknown variables and assumptions in the estimations. In fact, empirically the reaction to tax increases seems to be stronger for transactions than for FDI and profits in the financial sector, pointing to potential higher risks of erosion of the tax base of the FTT compared to the FAT …
>
> It is also very important to note that the impact of lower GDP (triggered by any of the above taxes) on revenue collection from other taxes is not accounted for. The deterioration of the tax base following relocation and product substitution might have effects that go well beyond the revenue shortfall, such as, for instance, the misallocation of financial funds in case some efficiency-enhancing market segments

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[37] *Forty-fourth report*, 2 November 2011 HC 428-xxxix 2010-12 para 4.11

[38] Schulmeister, S. (2011), "A General Financial Transaction Tax. Motives, Revenues, Feasibility and Effects." Presentation given at the Brussels Tax Forum on March 28 and 29, 2011.

[39] *Commission Staff Working Paper: Impact Assessment (volume 1)*, SEC(2011) 1102 final 28 September 2011 p32. Annex 11 to the impact assessment discusses these estimates in much greater detail.

> and/or products might disappear. This could have far reaching potential impact on the financing of investment projects.[40]

Notably the Commission's impact assessment did *not* provide a country-by-country breakdown of receipts from an FTT, though it cites estimates in a paper published by the Austrian Institute of Economic Research, which suggested that an EU-wide FTT would see 62% of receipts being collected in the UK.[41]

4.3 Initial reactions

As one would have expected, the Commission's proposals were strongly welcomed by campaigners for a 'Robin Hood' tax, and criticised by financial and business groups.[42] Writing in the *Financial Times*, the columnist John Pender argued that there was evidence that a well-designed levy could raise money, without undermining the financial sector, citing the UK's experience in charging stamp duty on stocks and shares:

> [The case against a Tobin tax] starts with the suggestion that the tax would impair market efficiency and be passed on to financial institutions' customers rather than being borne by banks. Then there is the concern that, in the absence of full international agreement, transactions would indeed migrate to less Tobinesque territory. Critics point to the Swedish experience of taxing equity and bond transactions between 1984 and 1991, which caused a dramatic decline in trading volumes and an exodus of business to London.
>
> Yet this overlooks the fact that Britain already has a financial transactions tax - stamp duty - in place since 1694. This has signally failed to prevent London's ascendancy in international finance. A reduction in financial trading volumes might anyway be no bad thing. The huge increase in bank balance sheets over the past two decades is primarily the result of the growth of trading between financial institutions, as opposed to lending to businesses and households. The social utility of much of this activity has been rightly questioned and trade in structured products has, as we know, been a systemic catastrophe.[43]

Further to this the then Archbishop of Canterbury, Rowan Williams, wrote a piece for the paper in which he supported the proposal, arguing "the objections made by some who claim [a 'Robin Hood Tax'] would mean a substantial drop in employment and in the economy generally seem to rest on exaggerated and sharply challenged projections - and, more important, ignore the potential of such a tax to stabilise currency markets in a way to boost rather than damage the real economy."[44]

An editorial in the paper argued that the comparison made between the UK's tax on shares and a Tobin tax was flawed, and that, as indicated by the IMF, there were better options when taxing the financial sector to charging a levy on transactions:

> Many point to the UK stamp duty on share transactions as proof that Tobin taxes are feasible. But stock trading in the City of London has a centuries-old first-mover advantage and a largely captive market for sterling equity financing. Both discourage

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40 *op.cit.* p33
41 SEC(2011) 1102 final (vol 12) p2, citing Schulmeister, S. (2011)
42 "Business lashes out at trading tax plans", *Financial Times*, 29 September 2011
43 "Long-term investors would benefit from Tobin tax", *Financial Times*, 28 September 2011
44 "Time for us to challenge the idols of high finance", *Financial Times*, 2 November 2011

avoidance. Other transactions are more footloose. Trading venues for entirely new products may well take transaction taxes into account when deciding where to set up shop.

Still, it is true that financial transactions require a clearing venue and a legal system enforcing contracts - something offshore jurisdictions cannot provide without the big economies' blessing. But without US support - which does not exist - the EU will struggle to impose a transaction tax on, say, derivatives unless it throws up transatlantic barriers amounting to a financial trade war ...

[However, most purposes Tobin taxes] are supposed to achieve are better pursued with other taxes. If the point is to tax banks and other financials more heavily, there are less distorting and less avoidable forms of taxation. One is to tax financial companies' balance sheets, as the UK's bank levy does. Another is to follow the International Monetary Fund's suggestion of a "financial activities tax" levied on the sum of compensation and profits - a measure of the value added of the financial sector which, scandalously, escapes value added tax in countries that levy it on everyone else.[45]

There were also concerns about how financial institutions might pass on the tax, or avoid it altogether:

When José Manuel Barroso, the European Commission president, proposed introducing a tax on financial transactions in Europe, it was clear whom he had in his sights. "It's a question of fairness," he said as he unveiled the proposal in Strasbourg last week. "It is time for the financial sector to make a contribution back to society." But bankers, analysts and investors point out that, instead of banks, such a tax would be likely to hit pension funds and other "long-only" savings vehicles and middle-sized companies that use derivatives to hedge against swings in commodity prices and currencies, because they would be the least able to avoid it.

According to bankers and corporate executives, Mr Barroso's stated target , the banks, will probably be able to pass much of the cost on to their customers and shift their internal hedging transactions out of Europe. Multinational companies may also be able to shift their transactions to offshore subsidiaries to avoid the tax. High-frequency traders, one of the main targets of the proposed legislation, would likely move offshore and shift more of their transactions from equities and bonds, which would be taxed at 0.1 per cent, to contracts for difference and derivatives, which would be taxed at 0.01 per cent ...

Manfred Bergmann, a European Commission official, says that the risks of avoidance were overstated. "We think now we have a design which leads to the closure of loopholes," he says. But the Commission's own impact study suggests that between 70 and 90 per cent of derivatives trading would be wiped out or displaced outside the 27-nation bloc. "If the transaction tax is applied as it is now envisioned, the UK as a financial centre dies," says a top London-based executive at a global bank.[46]

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[45] "Editorial: Europe's search for a silver bullet; Proposal for Tobin tax is populist, not productive", *Financial Times*, 29 September 2011. The paper's letters section carried an exchange of views on the Commission's proposals over the next few days: "Europe needs to put flawed Tobin tax to rest" & "Transaction tax would curb useless high-frequency trades", 30 September; " FTT – fiscal and financial suicide", 1 October 2001; "Think globally on transaction tax", 3 October 2011.

[46] "Warning of unintended outcomes with Tobin tax plans", *Financial Times*, 6 October 2011

Writing to the *Financial Times*, Stuart Fraser, Policy Chairman at the City of London Corporation, argued that the scale of this potential change meant that only an international tax would be workable

> Sir, While the unintended consequences of a European financial transaction tax are worrying ("Warning of unintended outcomes with Tobin tax plans", October 6), the consequences set out in the European Commission's own impact assessment - that between 70 per cent and 90 per cent of all derivatives trading could move outside of the European Union and that, consequently, the tax could cost more than it raises - should remain the overriding concern for European policymakers.
>
> Put simply, how can you tax something that is no longer here?
>
> Maintaining a thriving financial services industry and a network of global financial centres generates huge benefits for each of the 27 EU member states and has an important role to play in facilitating the broader economic growth that every European leader has identified as a priority.
>
> Clearly, with most of the revenues coming from the UK, a European FTT would be more of a tax on London than on the EU. However, the City is a huge asset for the EU as a whole and the impact of any such measure would be felt right across the Union. That is why, if European policymakers truly feel that a transaction tax is vital to shoring up our financial system, they must - as the UK government has already made clear - seek to create a global consensus through the Group of 20.
>
> Stuart Fraser,
> Policy Chairman, City of London Corporation[47]

4.4 The Coalition Government's position

For its part the Government strongly opposed the Commission's proposals on the grounds that any FTT would have to be charged globally to be at all effective:

> **Asked by Lord Myners :** To ask Her Majesty's Government whether they will ensure that United Kingdom businesses are not subject to the proposed European Union financial transactions tax.
>
> **The Commercial Secretary to the Treasury (Lord Sassoon):** Agreement to a directive on a financial transaction tax would require unanimity in the Council of Ministers, giving the UK Government a veto over any such proposal. Therefore such an EU tax cannot be imposed on the UK without the UK's agreement. While the UK Government are not opposed to financial transaction taxes in principle, the Government do oppose a European financial transaction tax. The Government believe that any financial transaction tax would have to apply globally to avoid transactions relocating to those countries not applying the tax.[48]

The Government's objections were set out in much more detail in a report on the Commission's proposals by the European Scrutiny Committee.[49] As part of this the then Financial Secretary, Mr Hoban, suggested that while the Commission had not calculated

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47 "Letters: How can you tax transactions that are no longer there?", *Financial Times*, 7 October 2011
48 HL Deb 13 October 2011 c253WA
49 *Forty-fourth report*, 2 November 2011 HC 428-xxxix 2010-12 pp-24

individual Member States' contributions to the revenue this tax might raise but that "the Government … estimates that over 50% of revenues … would derive from activity in the UK." Introduction of the tax would require national governments to remove existing national transaction taxes, including the UK's stamp tax on shares, and yet "abolition of this tax would deny the UK a simply, effective and sustainable revenue stream of over £3 billion per year." The Minister went on to contrast the proposals with both stamp duty on shares and the UK's bank levy:

- the stamp duty differs from the EU proposal in that the UK's carefully targeted stamp tax on shares (STS) is fundamentally different from the Commission's all-encompassing and poorly designed FTT;
- STS is efficient, enforceable and minimises impacts on market liquidity;
- the FTT as currently proposed by the Commission is inefficient, easy to avoid through relocation and would lead to dramatic reductions in market liquidity;
- the Government has already introduced a bank levy which reflects the risks banks pose to the financial system and the wider economy;
- the Commission's argument that the FTT is justified to ensure financial institutions make a fair contribution to recovering the costs of the crisis takes no account of existing national measures to achieve this objective, such as the UK bank levy.[50]

The Commission has stated that the Treaty base for an FTT could be Article 113, which provides for the harmonisation indirect taxes across the EU "to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition." In his submission Mr Hoban noted "the Commission proposal admits that the tax would be likely to lead to significant relocation of financial activity away from the EU … with the UK bearing a disproportionate share of this impact."[51] Following up this issue in their report, the Scrutiny Committee expressed particular concerns about the legal base of the Commission's proposal as, in its view, there were "strong arguments that the predominant aim of the FTT is not 'to ensure the establishment and the functioning of the internal market and to avoid distortion of completion'":

> The first recital[52] says that it "stems from the desire to ensure the financial sector contribute to covering the costs of the crisis and that it is taxed in a fair way vis-à-vis other sectors for the future; to dis-incentivise excessively risky activities by financial institutions; to complement regulatory measures aimed at avoiding future crises and to generate additional revenue for general budgets or specific policy purposes" — four aims in all, but none referring to the internal market.
>
> The second recital does, however, concern the internal market, but it serves as a justification for action at EU level rather than setting out an objective: it states that the features of the FTT should be harmonised at EU level in order to prevent distortions and thus ensure the proper functioning of the internal market through unilateral measures taken by Member States. The first two recitals are consistent with the introductory paragraph of the explanatory memorandum, where we note in particular that "[t]he purpose of the proposal is to provide a common European approach to this issue that is consistent with the internal market."[53]

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50 HC 428-xxxix 2010-12 p19, pp21-22

51 HC 428-xxxix 2010-12 p20

52 [The reasons for a particular piece of European legislation are set out in the 'recitals' to that law, which appear in the first section of the text.]

53 HC 428-xxxix 2010-12 pp 23-24

Writing to the Committee a few days later Mr Hoban agreed that "the proposals does not appear to be wholly focused on ensuring the proper functioning of the internal market" but did not offer a definitive opinion as to its legality because "in advance of detailed discussion with the Commission and Member States on the proposal it is difficult to fully understand what the primary purpose of the proposal is." While the Committee disagreed with this reluctance, it requested the Minister "respond to our questions on the purpose, and therefore legal basis, of the proposal in greater detail … once the negotiations have started."[54]

At this time the Treasury Committee wrote to the Chancellor on the potential impact of the tax on the UK, and in a letter to the Committee in December 2011 Mr Osborne suggested that an EU-wide FTT might not raise *any* additional money for the UK:

> First, the direct FTT revenues relating to UK activity vary considerably depending on the assumptions used on the scale of reduction in turnover in different markets in response to the tax. However, any gains in direct revenue would be offset by losses in other taxes, including £3 billion per year loss in stamp duty. We would also expect a reduction in corporation tax receipts from the financial service sector due to the impacts of the tax on the sector.
>
> In addition, we would expect further losses due to some FTT payments from financial institutions headquartered in other EU member states going to their home government rather than the Exchequer, and indirect losses in other taxes due to the negative growth impacts of the tax.
>
> Overall, it is possible that the tax might raise no additional money at all for the Exchequer.[55]

Further to this, in late 2011 the Lords EU Economic and Financial Affairs Committee launched an enquiry on the FTT; the Committee has published a large number of written submissions, and in one of these, Peter Sinclair, Professor of Economics at the University of Birmingham, addresses the question of the relative impact of the tax on the UK Exchequer:

> Although other possibilities are considered, the Commission's main FTT proposal is based on the principle that tax revenues accrue to the government(s) where the parties to a financial transaction reside. This is no a minor detail. Since most of the EU's wholesale financial transactions (the base of the proposed FTT) take place in London, but perhaps as much as 40% involve one financial firm (or sometimes two) headquartered or resident in another EU country, a substantial slice of FTT proceeds, perhaps 18% or so, would be transferred from the UK exchequer to other EU governments. Senhor Barroso opines that the FTT, if implemented in full, would build up to an annual EU-wide yield of some 55 billion euro.
>
> If these estimates proved correct, (and the Barroso figure may be much exaggerated) about 10 billion euro could be passed from London to other EU capitals. Yet when a British family buy dinner in France or pay a hotel bill in Italy, the VAT charged does not return to HMRC in London. Why the difference? There is also a hint that FTT revenues might be shared between the European Commission and the national governments; on that basis, FTT would constitute an even bigger conduit of funds from the UK to the rest of the EU. (It may be that the Commission's preference for (their version of) FTT over FAT has something to do with such covert transfers that FTT might entail, while FAT would presumably not).
>
> The annual loss of 10 billion euro, and possibly more, actually understates the impact on HM Government's finances. This is because, as the authors of the Impact

[54] *Forty-sixth report*, 18 November 2011 HC 428-xli 2010-12 pp 75-6

[55] Letter from Rt Hon George Osborne to Rt Hon Andrew Tyrie MP, Chairman, Commons Treasury Committee, 12 December 2011

Assessment volume allow for, some financial activity at present located in London (and other EU financial centres) would be diverted to more clement fiscal environments elsewhere. That would entail a loss of revenues from corporation tax, national insurance contributions, and income tax on remuneration currently paid to UK-based staff. The providers of wholesale financial services (the currency conversion, equity and bond transactions, and derivatives trading) which FTT proposes taxing would account, in recent years, for an average of perhaps 5 to 6% of UK GDP and some 8% of central government tax receipts.

Relocation of one third of these activities to other fiscal jurisdictions might, on this basis, be expected to lead to an additional annual revenue loss of £10-£12 billion, and an annual GDP loss of around £23 billion. These magnitudes are not small. And this correspondent has yet to find any discussion of the diversion effects of FTT on aggregate GDP for the EU (still less for its individual countries).[56]

On 8 November 2011 the Commission's proposals were discussed by European Finance Ministers, though without any agreement, with concerns being raised by many States including the UK.[57] Both the French and German governments appear to have been undaunted,[58] though the Government continued to restate their position that the UK would veto the tax unless it was adopted by the rest of the world.[59]

4.5 Failure to agree an EU-wide tax

Over spring 2012 discussions about an EU-wide FTT continued, though a good number of Member States remained sceptical or strongly opposed.[60] In March the Lords European Union Committee completed its report on the proposal, arguing that the Commission's proposal was "unlikely to fulfil the objectives that the Commission itself has set." Among the many concerns raised in the report, the authors were particularly worried that the new tax "seems destined to lead to a reduction in EU-wide GDP":

68. The European Commission's own Impact Assessment suggested that the introduction of an FTT would result in an overall total decrease of EU GDP in the long term of between 0.5% and 1.76%, depending upon the impact of certain "mitigating elements".[61]

69. The majority of witnesses were highly alarmed at these figures, arguing for instance that an FTT would act as a "tax on growth". The BBA considered it "extraordinary and counterintuitive that the European Commission should countenance introducing a tax which it acknowledges would significantly reduce the GDP of the EU." The Association for Financial Markets in Europe (AFME) argued that "at a time when the risk of recession in Europe is increasing, the focus of EU policy should be on measures that enhance growth and jobs and not on measures that both discourage

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56 House of Lords EU Economic and Financial Affairs & International Trade Sub-Committee, *Financial Transaction Tax : Oral and written evidence*, 28 November 2011 pp 190-1

57 The Government noted concerns were raised by Bulgaria, the Czech Republic, Italy, Luxembourg, Latvia, the Netherlands, Romania and Sweden (HC Deb 15 November 2011 cc31-33WS).

58 "France plans Tobin tax this year" & "Fresh clashes brew over Tobin tax", *Financial Times*, 5 & 6 January 2012

59 For example, by the Prime Minister in a BBC interview at this time: "Transcript of interview with the Prime Minister, David Cameron", *BBC News online: The Andrew Marr show*, 8 January 2012

60 "Analysis: Reviewing Member State support for the FTT", *Tax Journal*, February 2012

61 COM (2011) 594 FINAL, Commission Impact Assessment, op.cit., pp33,50 and Box at pp. 51–2. Commissioner Šemeta [European Commissioner for Taxation and Customs Union, Audit and Anti-Fraud] told us that the time period that the Commission had in mind for these calculations was approximately 40 years. See para 71 below.

> investment and fail to take account of the new regulatory requirements that are in train."
>
> 70. The CBI argued that the Commission's lower estimate was based on a number of questionable assumptions, including only factoring in the tax on securities and ignoring the tax on derivatives. They further pointed out that the Commission "has been unable to factor in the impact of a reduction in GDP caused by the new tax and points out that the deterioration of the tax base 'could go well beyond revenue shortfall'".112 Richard Woolhouse told us that "this may be one of the only taxes proposed that will fail to raise any revenue" [Q1].
>
> 71. Commissioner Šemeta regretted that "some of the figures that were derived in the preparatory stage of the impact assessment, such as the famous impact on GDP of 1.76%, were used to undermine the proposal." He explained that the design of the tax led the Commission to estimate the negative impact on GDP to be 0.53% in the long run. He told us that, since the approximate timeframe for this impact is a period of 40 years, the annual impact would be "negligible"—about 0.01% per annum. He further argued that all taxes have a negative impact on GDP when viewed in isolation, and that, in comparison with corporate income tax, the impact of an FTT would be low [Q125] …
>
> 79. We are particularly concerned that the Commission's model may have failed to take into account all of the potential negative impacts on growth, and that the effects could therefore be more pronounced than the Impact Assessment suggests. The impact would be exacerbated further should our fears of significant relocation be realised. Commissioner Šemeta has suggested that the impact may be limited to a decrease in GDP of 0.53% in the long term. Yet even that figure is concerning. The potential impact on liquidity is also uncertain. At a time of ongoing financial crisis and at best fragile economic growth across the entire EU, we consider that a new tax which could have a substantial detrimental impact on EU GDP should be resisted.[62]

In May 2012 the then Financial Secretary Mark Hoban wrote to the Committee, concurring with its conclusions, and in particular, raising similar concerns about the impact of the tax on the economies of all Member States:

> Rather than using a residency principle suggested by the Commission in determining who should pay the tax, our experience from the UK's Stamp Taxes on Shares regime is that the principle of issuance enables the efficient collection of revenue.
>
> One of the key concerns with any sub-global FTT is that it will lead to this very mobile sector simply relocating to areas which do not impose the tax. For the EU, with major trading centres such as London, Paris and Frankfurt, this could lead to devastating economic consequences. The Commission's own impact assessment provides that their central estimate of the negative impact on growth is 1.76 per cent of EU Gross Domestic Product. This equates to over €200 billion, and would lead to the loss of nearly half a million jobs. At this time, we strongly believe that the EU should be discussing how to deliver economic growth, and how to deliver employment opportunity rather than the introduction of a tax which would have such detrimental economic consequences for the EU.[63]

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[62] House of Lords European Union Committee, *Twenty ninth report: Towards a Financial Transaction Tax?*, 30 March 2012 HL Paper 287 of 2010-12 pp24-5, p27

[63] *Letter from the Financial Secretary to Lord Harrison (Chair, Economic and Financial Affairs and International Trade sub-Committee)*, 24 May 2012

While the European Parliament endorsed the Commission's proposals at this time,[64] there was no indication at their council meetings that European Finance Ministers were coming to a unanimous position on the matter,[65] and at its meeting on 22 June it was agreed that the proposal for an EU-wide tax should be put on hold – as the Chancellor reported in a Ministerial Statement a few days later:

> *Financial Transactions Tax*
> Following a presentation by the presidency, Ministers debated the future direction of this dossier. A number of member states expressed concerns and stated their opposition to an FTT and I intervened to reiterate UK opposition to the Commission's proposals in this area, given the negative impacts on jobs, growth and on financial activity across the EU at a time when we should be doing all we could to attract business and drive growth. I also underlined that any new proposal put forward for consideration under enhanced co-operation must provide clarity on the scope of the tax and what the revenues would be used for.
>
> The presidency concluded that support for an FTT as proposed by the Commission was not unanimous, but that some member states wished to further consider enhanced co-operation on this dossier. The presidency noted that formal requirements for enhanced co-operation would have to be met, and that next steps will be handled by the incoming Cyprus presidency.[66]

4.6 A European FTT for a minority of Member States

In October 2012 eleven Member States agreed to pursue the option of having a Tobin-like levy on a smaller scale. Under the procedure of 'enhanced co-operation', a limited number of countries may implement a measure, as a press notice issued by the Council of Finance Ministers explained:

> Formal requirements for enhanced cooperation are laid down in article 20 of the Treaty on European Union and articles 326 to 334 of the Treaty on the Functioning of the European Union. A decision to authorise enhanced cooperation is taken by the Council "as a last resort" once it has established that the objectives cannot be attained within a reasonable period by the EU as a whole, and provided that at least nine member states participate (article 20(2) TEU).
>
> They must submit a request to the Commission, specifying the scope and the objectives of the enhanced cooperation, and the Commission may submit a proposal to the Council to that effect. Authorisation to proceed with the enhanced cooperation can be granted by the Council, via qualified majority vote, after obtaining the consent of the European Parliament (article 329(1) TFEU). The substance of the enhanced cooperation must be agreed unanimously by the participating member states.[67]

The Chancellor set out the UK's position on this initiative in his written statement on the outcome of this meeting:

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64 European Parliament press notice, *Parliament adopts ambitious approach on financial transaction tax*, 23 May 2012

65 HC Deb 23 March 2012 c77WS; HC Deb 18 April 2012 c22WS

66 HC Deb 2 July 2012 c30WS

67 ECOFIN press notice 14469/12, *3189th Council Meeting*, 9 October 2012 p6. See also, HC Deb 16 October 2012 c271W.

> [At the meeting on 9 October] Ministers were updated on developments since this was discussed at ECOFIN in June. The June European Council had suggested adoption of the enhanced co-operation proposal by the end of the year, and the presidency suggested it would be helpful if those member states willing to participate would indicate their intentions and for the Commission to set out a time line for next steps. Eleven member states indicated their willingness to participate: formal representations in writing are required, after which the European Commission will assess the request.
>
> I intervened to confirm that the UK would not be joining. I stressed that the UK is not against taxation of the sector and already has a bank levy. We would not seek to stand in the way of enhanced co-operation: however this must be done in the context of a clear proposal and in line with the treaty. Currently there remains uncertainty over the likely scope and the purpose for which the revenues would be used. I pointed out that the Commission's own original assessment had foreseen a GDP reduction of between 0.5% and 3.5% for the European economy: the impact on all 27 member states must be considered and therefore we want to see a specific proposal.[68]

In turn the Commission announced that, in its view, the legal conditions for enhanced cooperation had been met in this case.[69] The Commission gave some details of its assessment in a memorandum, from which the following text is taken:

> Enhanced cooperation is when a group of at least 9 Member States decide that they will move ahead with an initiative proposed by the Commission when it proves impossible to reach unanimous agreement on it. 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 …
>
> The Treaties set out certain requirements if enhanced cooperation is to be allowed. In addition to those conditions already outlined above (no possibility of unanimity, minimum of 9 Member States, open to others joining at any stage etc) the Commission must also assess such questions as:
>
> - *Would enhanced cooperation in this area further EU objectives?*
>
> Today's proposal concludes that enhanced cooperation on an FTT would support the EU's objectives and reinforce the integration process, particularly when it comes to establishing a strong internal 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.
>
> - *Would enhanced cooperation have any negative effect the Internal Market, pose a barrier to trade or distort competition within the EU?*
>
> Today's proposal states that enhanced cooperation on FTT would contribute to a stronger Single Market, with less barriers and competitive distortions. A common system of taxing the financial sector, even if not applied by all Member States, is preferable to the fragmentation that would result from 27 different national systems. Financial operators throughout the EU would benefit from the simplification that a harmonised approach brings. Moreover, the risks of double-taxation and double non-

[68] HC Deb 16 October 2012 cc11-12WS

[69] European Commission press notice IP/12/1138, 23 October 2012

taxation are reduced, because the fewer divergent tax systems there are, the fewer the overlaps and loopholes between them.

- *Would enhanced cooperation respect the rights, competences and obligations of non-participating Member States?*

Today's proposal states that the rights, competences and obligations of non-participating Member States would be fully respected with enhanced cooperation on FTT. For example, non-participating Member States would not be precluded from having their own national FTT if they wanted to, outside the harmonised system.[70]

European Finance Ministers authorised this initiative to proceed in January 2013,[71] though at this time the UK Government argued that the conditions required for enhanced cooperation had not been met.[72] The Commission published draft provisions the following month.[73] The European Scrutiny Committee set out the key features of the proposal in their report published on 4 April:

- the FTT would have a wide base as well as provisions to prevent the relocation of financial activity outside of the FTT zone;
- as in the original proposal a 'residence principle' would apply, meaning that the tax would be due if any party to the transaction were established in a participating Member State, regardless of where the transaction took place;
- this would be the case both if a financial institution engaged in the transaction were, itself, established in the FTT zone, or if it were acting on behalf of a party established in that jurisdiction;
- an FTT zone financial institution's branches worldwide would therefore be subject to the FTT on all relevant transactions — for example, French and German banks' London and New York branches would be fully subject to the FTT on all their securities and derivatives businesses;
- equally non-FTT zone financial institutions (for example, those in London, Dublin, Luxembourg, New York and Asia) would be taxed whenever they transacted with parties in the FTT zone and whenever they dealt in securities issued by an entity established in the FTT zone or on behalf of such an entity;
- in order to mitigate the risk of relocation, reliance is put on the residence principle to ensure that if any party to the transaction were established in the FTT zone, the transaction would be taxed, regardless of where in the world it took place — financial operators would only be able to avoid the FTT if they were prepared to relocate and relinquish their clients and business in the eleven participating Member States and the Commission hopes that the relatively low headline rates would deter such relocation;
- as "a further safeguard against avoidance of the tax", the proposal also adds an 'issuance principle', meaning that financial instruments issued in the FTT zone would also be taxed when traded, even if those trading them are not established within the FTT zone; and
- in general only equities and bonds would be subject to this issuance principle, however there might be scenarios where other products, such as derivatives traded on organised trade platforms, would also be affected.[74]

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[70] European Commission MEMO 12/799, *Enhanced Cooperation on Financial Transaction Tax – Questions and Answers*, 23 October 2-12

[71] ECOFIN press notice 5555/13, 22 January 2013. The participating States are, Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia

[72] HC Deb 30 January 2013 cc 40-41WS

[73] COM (2013) 71 Final, 14 February 2013. See also, European Commission press notice IP/13/115, 14 February 2013. Further details are collated on the Commission's site. see also, "The whys and wherefores of an EU 'Tobin tax'", *Financial Times*, 4 March 2013

[74] *Thirty-eighth report*, 4 April 2013, HC 86-xxxvii para 2.7

The Committee went on to note that the Commission had provided an updated assessment of the macroeconomic impact of the FTT, suggesting, "that it would not lead to any job losses, whereas its original proposal's impact analysis suggested around 500,000 jobs would be lost."

> In terms of economic impact, it estimates the present proposal to have a -0.28% impact on EU GDP in the long run, whilst the previous central estimate was -1.76% — the difference stems mainly from revised economic modelling used by the Commission. The Commission also highlights its view that these negative GDP impacts could potentially be negated by spending FTT revenues on growth enhancing public investment, which it estimates could have a positive impact on GDP of between 0.2 and 0.4%. It expects an enhanced cooperation FTT to generate €31 billion a year, corresponding to 1% of the participating Member States' tax revenues.[75]

In evidence to the Committee, the Financial Secretary, Greg Clarke, underlined a number of shortcomings to this impact assessment:

- it gives only very limited detail on how the proposal would impact non-participating Member States;
- specifically, it does not provide any detail on either the contribution to the tax take that the Commission expects from individual non-participating Member States, nor an assessment of the economic impacts on non-participants, including for example, impacts on GDP and levels of employment;
- it provides no assessment of the impacts the FTT would have on the existing tax base of non-participants; and
- with the UK having the largest financial services sector in the EU, this lack of impact analysis on such key issues is a clear cause for concern and an issue that the Government will proactively raise in future discussions.[76]

The Committee concluded that the draft text, and the Council's consent to enhanced cooperation, should be debated on the floor of the House.[77]

A few days after the Committee's report, the Government made an application to the European Court of Justice to have the Council's decision to authorise 'enhanced cooperation' annulled. Treasury officials were reported to be confident that negotiations could ensure that a final FTT did not affect financial institutions outside the eleven States, but that making a legal challenge at this early stage would ensure that the UK could pursue the option, if this assessment proved over-optimistic.[78] Subsequently the Financial Secretary, Greg Clark, wrote to the Committee with details:

> [In his letter] the Minister, noting that the Government's application focuses on the extraterritorial elements of the tax, says that:
>
> - in the Government's view, if the FTT Directive were adopted in its current draft form, the tax would infringe the rights and competences of non-participating Member States and would depart from accepted international tax norms;
> - specifically, the Government has concerns about the proposed "deemed establishment rule" under which financial institutions in non-participating Member

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75 HC 86-xxxvii para 2.8

76 HC 86-xxxvii para 2.12

77 HC 86-xxxvii paras 2.15-6. The House has not debated these documents as yet.

78 "Osborne challenges EU Tobin tax", *Financial Times*, 20 April 2013; "UK challenges EC's enhanced cooperation on FTT", *Tax Journal*, 26 April 2013 p6

States would be deemed to be established in the FTT zone (and hence liable for the tax) when dealing with counterparties based in the FTT zone; and

- it considers this is likely to breach Article 327 TFEU (concerning respect for the competences of Member States not engaged in enhanced cooperation) and to be in conflict with international tax law and customary international law.

The Minister adds that:

- the tax in the form proposed by the Commission could oblige UK tax authorities to collect the FTT under existing EU agreements on mutual assistance;
- this, however, raises fundamental concerns, as Article 332 TFEU provides that expenditure resulting from implementation of enhanced cooperation shall be borne by the participating Member States; and
- as a result, the Government is also challenging the Directive on this ground.

The Committee took the view that this was a "sensible precautionary measure" while looking forward to the House debating the questions it had raised "in the near future".[79]

On the question of legality, on 11 September the *Financial Times* reported that the European Council's legal service had completed a memo, concluding that the FTT in its proposed form was legally defective: specifically, that the extension of the FTT to financial institutions based outside the FTT zone – the 'deemed establishment' rule – exceeded Member States' national jurisdiction, encroached on the fiscal competencies of non-participating States, and, would be discriminatory, leading to a distortion of competition across the EU.[80] The legal opinions given by the Council's legal service are not binding, though the paper's blog on European issues suggested, "this is … unusually clear, blunt and damning … Most Council legal service opinions are a model of equivocation. To be as forthright as this, the service needs to be absolutely confident about the legal argument, or enjoy a permissive political backdrop to make the case (ie, important finance ministries either agree or are not displeased to see the opinion published)."[81]

In addition to these concerns, over the past months there have been reports that concerns from the financial sector about the potential impact of the tax were likely to result in the scope of the tax being reduced, and its implementation date delayed.[82] At the presentation of the Bank of England's quarterly inflation report on 15 May, the present Governor, Mervyn King was asked what the impact the FTT might have on the British economy; in his response the Governor noted that there was "considerable scepticism" among central bankers as to whether it had a future:

> Well I don't think it's likely to help very much, and indeed the thing I find most striking is that within Europe I can't find anyone in the central banking community who thinks it's a good idea. So I think you will see over the next months some considerable debate which will end up with more time and reflection being taken before designing anything in this area.

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[79] European Scrutiny Committee, *Fortieth report*, 2 May 2013 HC 86-xxxix 2012-13 para 2.8-9, para 2.12-3

[80] "Europe's financial tax plan hits wall", *Financial Times*, 11 September 2013. See also, "Legal flaw 'is final nail in coffin' for transaction tax", *Times*, 11 September 2013 & "EU financial transaction tax illegal, say lawyers", *BBC News online*, 10 September 2013

[81] "EU legal opinion against the FTT", *Financial Times Brussels blog – notes from the EU*, 10 September 2013. The opinion is not published, but the paper's blog posted the copy it had obtained it on its site.

[82] For example, "Analysis – Robin Hood tax: a long shot", *Financial Times*, 21 May 2013

> Of course the words financial transactions tax, mean very different things to different people. Some people would use it to cover something like stamp duty on equities. Others would use it to a much greater extent for a small tax on all financial transactions. I don't think we're remotely close to getting any clear view on any of this; all I would say is that I can understand why at least some politicians feel reluctant to express their true scepticism about the merits of this idea in public. But I can assure you I do hear an enormous scepticism even from quarters which are alleged to be behind it.[83]

The House debated the Scrutiny Committee's report on 18 June.[84] Speaking for the Opposition Chris Leslie acknowledged that "the EU variant of the FTT was [not] optimal", but argued that a tax with "the widest global participation" should be pursued, as "an idea whose time has come."[85] In his speech the Financial Secretary focused on the Government's opposition to the Commission's proposals, and the case that the FTT's 'establishment rule' was in contravention of the Treaty:

> [The proposal] contains a feature known as the "establishment rule", under which a UK financial institution would be deemed to be established in the FTT area for the purpose of the tax by virtue of the mere fact that its trading counterparty is headquartered in a country participating in the tax. So in practice, a UK pension fund purchasing a UK Government bond from a UK branch of a German bank would be obliged to pay the tax, and it would pay the tax not to the Exchequer in this country, as would have been the case if we had signed up to the FTT, but to an overseas authority. Likewise, a UK company with significant Treasury operations would potentially be in scope of the FTT when its counterparty happened to be headquartered in the FTT area …
>
> The enhanced co-operation procedure is available to member states provided it is legal and compliant with the treaty, and our view is that it is certainly not. In particular, the extra-territorial effects … are contrary to article 327 of the treaty on the functioning of the European Union, as it fails to respect the competences, rights and obligations of the non-participating member states. Furthermore, the decision to proceed with the FTT has extra-territorial effects for which there is simply no justification in customary international law.

The Minister was asked why the Government would not pursue an alternative, given the interest shown in an FTT at the 2009 meeting of the G20; he replied:

> It was agreed at Pittsburgh in 2009 that the International Monetary Fund should conduct a study to establish whether there was an international basis for proceeding. It conducted that study, and found that there was no such basis. I hope that, given the international concern about the proposed tax, the House understands that we have no choice but to challenge it. Not only are there numerous problems with the design, but the proposal flagrantly disregards the position of those who choose not to participate.[86]

[83] Bank of England, *Quarterly Inflation Report Q&A*, 15 May 2013 p27
[84] HC Deb 18 June 2013 cc787-817
[85] HC Deb 18 June 2013 c798, c801, c803
[86] HC Deb 18 June 2013 cc 988-9, cc790-1