MEMO/11/640

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Common Rules for a Financial Transaction Tax – Frequently Asked Questions

(see also IP/11/1085)

1. General background

Why has the Commission proposed a new tax on the financial sector?

For two main reasons:

1. the financial sector would make a fair contribution to the cost of the crisis after benefiting from very significant financial support from governments since the beginning of the current crisis
2. a coordinated framework at EU level would help to create a stronger internal market for financial services by avoiding competitive distortions and discouraging risky trading activities. It would also be a strong signal to promote the introduction of such a tax at global level

Why is a financial transaction tax necessary at EU level?

It is appropriate to set up a harmonised tax at EU level to create a solid internal market for financial services. The financial transaction tax would prevent evasion, avoid double taxation and minimise distortions of competition within the EU's Single Market. The objective of the proposal could not be sufficiently achieved by the Member States acting by themselves.

Is there support for the introduction of a financial transaction tax?

Yes. According to the latest Eurobarometer, 65% of European citizens are in favour of a financial transaction tax.

Do financial services currently enjoy preferential treatment compared with other sectors?

Yes. Financial services are, in the majority of cases, exempt from paying VAT (due to difficulties in measuring the taxable base). This leads to the under-taxation of financial services.

In addition, the financial sector benefits from very high profit margins and the implicit protection from governments in the current economic crisis.

Why is the Commission promoting a financial transaction tax at global level?

A financial transaction tax is needed not only at EU level but at global level because financial markets are increasingly interconnected and have a global dimension. By proposing a financial transaction tax at EU level first, the Commission intends to be in a position to promote such a tax at global level in the framework of the G20.

The Commission has discussed the introduction of a financial transaction since 2009 on several occasions in the G20 (Pittsburgh, Toronto). With the support of the current French Presidency of the G20, the introduction of a financial transaction tax at global level could be on the table at the next G20 summit in Cannes on 3 and 4 November.

2. Definitions

What is a financial transaction tax?

A financial transaction tax (FTT) is a tax applied to financial transactions, usually at a very low rate. A financial transaction applies to the exchange of financial instruments between banks or other financial institutions. The financial instruments in question include securities, bonds, shares and derivatives.

They do not include the transactions typically undertaken by retail banks in their relations with private households or businesses, except when they relate to the sale or purchase of bonds or shares.

What is a financial institution?

The definition of a financial institution in the Commission's proposal covers a wide range of institutions in order to avoid circumvention of the tax and includes essentially investment firms, organised markets, credit institutions, insurance companies, collective investment undertakings and their managers, alternative investment funds (such as hedge funds), financial leasing companies and special purpose entities.

What is the difference between transactions carried out on organised markets or over the counter?

Within the derivatives markets, many products are traded through exchanges on organised markets. Products traded on the exchange must be standardised for the purpose of transparent trading.

Non-standard products are traded in the so-called over-the-counter (OTC) derivatives markets. OTC derivatives have a less standard structure and are traded bilaterally (between two parties).

What is the residence principle?

The financial transaction tax would be based on the principle of tax residence of the financial institution or trader. Taxation would therefore take place in the Member State in which the establishment of the financial institution involved in the transaction was deemed to be located. This would help to reduce the risk of relocation, because a financial transaction would be taxed in each case where an EU resident was involved even if the transaction was carried out outside the EU.

3. 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.

Why will the Commission propose a very wide tax base?

The Commission has proposed that the financial transaction tax would have the broadest basis possible in order to reduce the risks of tax avoidance and market relocation. The tax base would be defined on the basis of trading activities carried out by financial institutions. The financial instruments covered would include shares, bonds, their substitutes and related derivatives.

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.

Why will the Commission propose these specific rates?

The Commission has decided to propose minimum rates to mitigate the risk of relocation on the one hand and to guarantee revenue for the EU and Member States on the other hand.

Where will the tax be applied?

The tax would be applied on the territory of the 27 Member States of the European Union. It would apply to all financial transactions on condition that at least one party to the transaction were established in a Member State of the EU and that a financial institution established in the territory of the Member State concerned was party to the transaction.

In cases where EU countries applied a national tax on financial transactions, the tax would have to comply with EU rules. All EU countries would have to respect the minimum rates of taxation for the various transaction types.

How will the tax be applied in practice to a transaction?

Both parties to the transaction would pay their share of the tax in their country of residence or deemed residence.

How will such a tax interact with Member States' tax systems?

Belgium, Cyprus, France, Finland, Greece, Ireland, Italy, Romania, Poland and United Kingdom already have a form of financial transaction tax in place. They may have to modify their national rules to align them with the rules proposed by the Commission. This means Member States would have to apply the minimum rate and harmonise the tax base as provided by the EU rules on the financial transaction tax. Other Member States would have to put in place the tax as proposed by the Commission.

4. Revenue raised by the financial transaction tax

What will the proceeds of a financial transaction tax be used for?

Like any other tax, a financial transaction tax can help to contribute to public finances, which is spent in the public interest. In the case of a financial transaction tax at EU level, part of it could go to the EU budget and another part could help to finance the budgets of Member States. Although it is general practice in the EU budget and in national budgets not to affect the proceeds of a tax to a particular policy, it should be noted that a fair share of the EU budget is devoted to growth and jobs, as well as addressing global challenges such as development and climate change.

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.

Are there estimates of how much money could be raised?

At a rate of 0.1% for bonds and shares and 0.01% for other kinds of transactions such as derivatives, the tax could raise approximately € 57 billion per year.

Why does the Commission propose to use part of the revenue generated by a financial transaction tax as a future own resource for the EU Budget?

In its proposal for the next financial framework (2014-2020), the Commission has proposed to introduce two new own resources: a tax on financial transactions and a modernized VAT resource. The new own resource system managed by the Commission would be made fairer as a more transparent link could be created between EU policy objectives and EU financing. The financial transaction tax could considerably reduce Member States' contributions and thus contribute to budgetary consolidation efforts in the Member States. It is estimated that by 2020, the new own resources could amount to almost half of EU budget revenue, while the share of Member Stat's GNI-based contributions will go down to around one third from over three quarters today (IP/11/799, MEMO/11/468).

Who will benefit and how?

All citizens and enterprises would benefit from this tax through extra public revenue which could be used for generating more economic growth and prosperity in the EU. The Member States would also benefit from this new public revenue stream both as direct financing for their own budgets and reduced contributions to the EU budget.

Finally, the financial transaction tax could become a new "own resource" for the European Union to finance its policies for the benefit of all.

5. Mitigation of risks

How will the proposal mitigate the risk of the tax being passed on to consumers?

The Commission has proposed that the tax should cover only transactions where financial institutions are involved. The aim is to tax the financial sector, not their clients. The tax would aim at covering 85% of the transactions that take place between financial institutions.

However, in case private households and enterprises were to purchase or sell financial products, financial institutions could pass on the tax. For instance, for a purchase of shares to the value of €10 000 the bank could charge €10, which is not excessive.

What risks could the introduction of such a tax bring? What solutions are proposed to mitigate such risks?

The main risks would be incidence of the tax (i.e. who bears the final burden of the tax), relocation of financial institutions to other countries, economic distortions and potential loss of competitiveness. In order to mitigate these risks, the proposal provides for low tax rates (differentiated per product group), a very wide tax base, appropriate criteria to determine the territorial application of the tax (to tax at the place of establishment of the financial institution) and harmonised scope.

6. Next steps

What are the next steps?

The proposal now needs to be discussed and agreed unanimously by Member States in the EU's Council of Ministers, following the opinion of the European Parliament. In parallel, the Commission will explore ways to introduce a financial transaction tax at global level, notably with its international partners in the G20.

When would the proposed tax enter into force?

The Commission has proposed that the tax should come into effect from 1st January 2014, but this depends on when the Council adopts the proposal.