HOUSE OF LORDS
European Union Committee

House of Lords
London
SW1A 0PW

Tel: 020 7219 6083
Fax: 020 7219 6715
euclords@parliament.uk
www.parliament.uk/lords

Mr Algirdas Šemeta
European Commissioner for Taxation and Customs Union,
Audit and Anti-Fraud
European Commission
B-1049 Brussels
Belgium

16 April 2013

Dear Commissioner Šemeta

**EMs 6442/13 and 15390/12: Financial Transaction Tax**

I am writing in relation to COM (2013) 71 on the proposal for a Council Directive implementing Enhanced Cooperation in the area of Financial Transaction Tax. On 19 March 2013, the House of Lords European Union Sub-Committee on Economic and Financial Affairs heard important evidence on the proposal from Manfred Bergmann, Director of Indirect Taxation and Tax Administration, DG TAXUD, European Commission. I would like to thank you for agreeing to Mr Bergmann's attendance at the meeting, as well as your own appearance before the Sub-Committee in relation to the Financial Transaction Tax proposals one year ago. The Committee also heard evidence on 19 March from John Vella, Senior Research Fellow, Oxford University Centre for Business Taxation; and Richard Woolhouse, Head of Tax and Fiscal Policy, CBI, and the EU Select Committee heard evidence from the Financial Secretary to the Treasury, Rt Hon Greg Clark MP, on 13 March.

There are a number of issues arising from the evidence that we heard that we wish to share with you and invite your views on.

***The detail of the proposal***

We are deeply concerned at the lack of clarity as to the impact of this proposal. We have once again heard serious criticism of the standard of the Commission's Impact Assessment. Our March 2012 report, *Towards a Financial Transaction Tax?*, drew attention to the flawed nature of the Impact Assessment pertaining to the original proposals, and we are disappointed to find that the situation has not improved.

There is a noticeable lack of clarity about the means of collection of the tax and the use of any revenue accrued. Mr Bergmann told us that there was a three stage process: first, the

design of the tax; second, how to collect it; and third, how to spend it, that discussions on the second and third stages would follow in due course, and it would be a choice for Member States whether revenue collected was used as an Own Resource for the EU budget. We are astonished by the paucity of thinking exhibited by the Commission. Detailed assessment of all aspects of such a tax, including the method of collection and the use of potential revenue, must be undertaken as a matter of urgency before further steps towards its implementation are taken.

The proposal is particularly weak in relation to two other issues: the impact of the new issuance principle, and the impact on non-participating Member States, including the UK.

***The issuance principle***

Witnesses told us that, whilst the issuance principle is intended as an anti-avoidance measure, it goes far beyond what was justified to meet this aim. We were told that use of the issuance principle in the way proposed by the Commission was unprecedented and risked being non-compliant with customary international law, under which a genuine link with the transaction being taxed needed to be demonstrated. There was also criticism of the lack of detailed analysis of the effect of the issuance principle in the Impact Assessment. How would you respond to these criticisms?

***The impact on non-participating Member States***

The UK will not participate in the enhanced cooperation FTT. Yet we have consistently pointed that the implications of such an FTT for non-participating Member States, such as the UK, could still be significant.

Our March 2012 report stated that, in relation to the original proposal, UK financial institutions entering into financial transactions with financial institutions in participating Member States would still be liable for the FTT, which could be collected through EU mutual assistance for the recovery of tax or as a result of provisions of joint and several liability. We found that, in the event of a transaction between a bank in a participating Member State and a bank in the UK, tax authorities in participating Member States could request the UK tax authorities to collect the FTT from the UK institution: the legal basis for the request would be the EU regime for mutual assistance on tax matters, and such requests would have to be met. More likely the participating tax authorities would rely on the provisions of the proposal imposing joint and several liability on the bank in the participating Member State. Knowing this, the bank in the participating Member State would be likely to ensure, through its contractual relations with the UK bank, that it would be indemnified by the UK bank.

When we put this to Mr Bergmann, he told us that there would be no legal obligation on UK tax authorities to collect the tax. Notwithstanding his evidence, it remains our understanding that UK financial institutions which are counterparties to financial transactions with an EU established financial institution would have to pay the tax, and it could be collected either from the EU financial institution on the basis of joint and several liability or through the mutual assistance regime. Similar procedures would apply in relation to tax which is imposed on the basis of the issuance principle. Indeed there may be far-reaching adverse consequences for UK-resident financial institutions. This is illustrated by the case of a financial transaction involving German shares between a US and a UK financial institution.

Under the issuance principle this would give rise to FTT upon both parties payable to the German tax authorities. Given that collection of this tax from the US financial institution may be difficult, the proposal would enable the German tax authorities to impose joint and several liability for both instances of the FTT upon the UK financial institution and recover the whole amount using the EU mutual assistance regime.

These issues are of great significance for UK authorities and financial institutions, as well as other non-participating Member States, and we deeply regret your failure to provide any detailed analysis of such effects on non-participating Member States in your Impact Assessment. Please provide us with a categorical statement of the obligation that would be placed on UK authorities to collect the tax, in the light of Article 10 of the proposal and Directive 2010/24.

***The impact on economic growth***

One of the concerns in our original report was the potential deleterious effect on economic growth. The Commission's most recent analysis suggests that the FTT will not lead to any job losses, whereas the original proposal predicted the loss of 500,000 jobs, and that this proposal is estimated to have a -0.28% impact on EU GDP, compared to -1.76% in relation to the original proposal. However, we were told that the modelling used by the Commission contained significant flaws. For instance, it only made calculations on the basis of a tax on securities but not derivatives, and it assumed a closed economic model (and therefore did not take account of potential relocation effects). The City of London have recently argued that analysis of the impact of the FTT has been based on the incorrect assumption that the FTT could be implemented effectively without resulting in behavioural change. How would you respond to these criticisms? Assessment of the impact of proposals of such importance as this must be based on rigorous analysis, or else all assumptions that follow will be flawed.

***The potential for a global tax***

The Commission has once again expressed the hope that an enhanced cooperation FTT could pave the way for a tax at global level if it was able to show that the model worked. It remains our view that, given the palpable lack of appetite for the introduction of a tax amongst other nations, most notably the USA, the Commission's argument that an EU-wide FTT would pave the way for the introduction of a global tax is wholly unrealistic. Given potential US hostility to the proposal, we also fear the potential implications for the EU-US trade negotiations.

***The enhanced cooperation criteria***

The Treaty on the Functioning of the European Union requires that enhanced cooperation "shall not undermine the internal market or economic, social and territorial cohesion. It shall not constitute a barrier to or discrimination in trade between Member States, nor shall it distort competition between them." Enhanced cooperation must also "respect the competences, rights and obligations of those Member States which do not participate in it". Taking the evidence that we have heard into account, we believe that the proposal fails to meet the criteria for enhanced cooperation. It is particularly unacceptable that a full analysis of the impact of the proposal on non-participating Member States was not made available

before the vote on enhanced cooperation took place. This suggests that the Commission has failed in its duty to the 16 Member States who have thus far chosen not to participate in the tax. We have therefore exhorted the UK Government to take urgent legal advice on the case for a legal challenge at the European Court of Justice.

Yours sincerely

Tim Boswell

The Lord Boswell
Chairman of the European Union Committee